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SECTION 18A TAX-DEDUCTIBLE DONATIONS

GROSS INCOME
DIVIDEND PAYMENT CYCLES

VALUE-ADDED TAX
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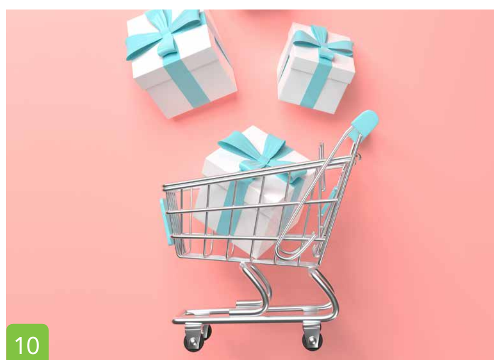
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GAAR IN THE CONTEXT OF INTERLOCUTORY APPLICATIONS

In 2006, South Africa introduced Part IIA of the Income Tax Act, 1962 (the Act), dealing with impermissible avoidance arrangements, more commonly known as the new general anti-avoidance rules (GAAR). Since then, very few cases have come before our courts which consider the application of these provisions.

Judgment was delivered in ITC 1940 [2020] on 12 November 2020. In this case, the tax court had to consider the application of some of the provisions of the GAAR. As indicated in the judgment, the matter involves the combined hearing of two separate tax appeals by Mr X and Mr Y. In short, the tax court had to consider the following three issues, which were applicable to both tax appeals:

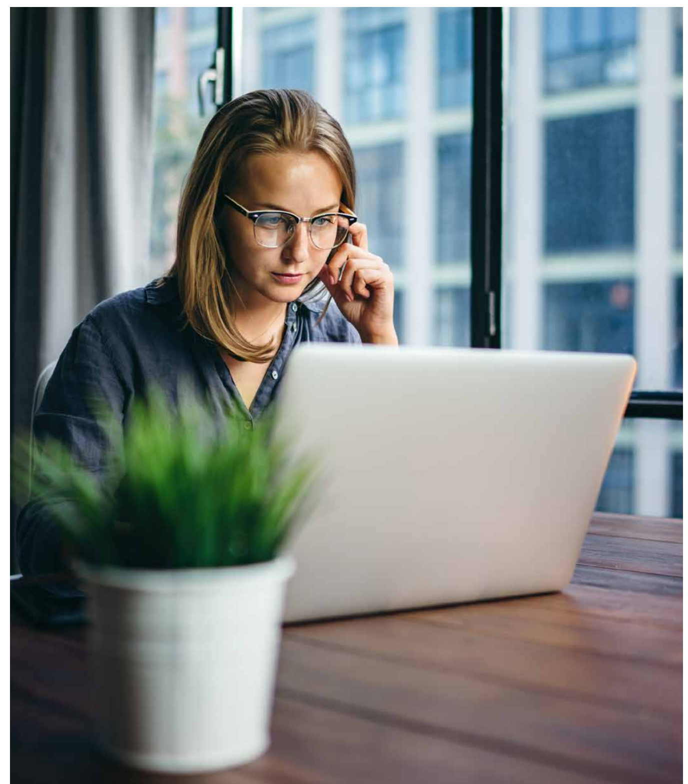
- Whether certain allegations made by the Commissioner for the South African Revenue Service (SARS) in its Rule 31 statements filed in the tax appeals should be struck out;
- Whether certain legal issues arising on the pleadings should be determined separately; and
- Whether SARS or the taxpayers had the duty to begin leading evidence at the appeal hearing(s) on the merits of the respective tax appeals.

The judgment is lengthy, mainly due to the complexity of the facts that form the subject matter of the tax appeals. The tax court's finding regarding the separation issue (second bullet above) was an ancillary issue to the first issue and is therefore not discussed in any detail. We do not provide a detailed exposition of the facts, but only set out those facts that are relevant to understand the tax court's decision on the three issues referred to above.

FACTS

Mr X application

- On 26 October 2015, SARS dispatched to Mr X a notice of audit letter informing him that an audit would be conducted into his 2006 to 2012 years of assessment.
- On 30 October 2015, SARS issued a letter incorporating both its audit findings and a section 80J notice, indicating its intentions to invoke the GAAR in raising the additional assessment (the 80J notice).
- In the 80J notice, SARS alleged that Mr X was, pursuant to preliminary audit findings, involved in certain arrangements which, despite being reportable, were not disclosed.



- The transactions alleged to constitute impermissible avoidance arrangements, involve agreements concluded between various South African companies, including A Investments, and various companies in the Isle of Man. More specifically, these arrangements are said to consist of the following:
    - The transactions between A Investments, its subsidiaries and the Isle of Man companies;
    - The declaration of certain A Investments promissory notes to Mr X;
    - The "settlement" of the promissory notes held by Mr X by means of A Investments becoming obliged to pay those parties the net income from specific transactions involving specific subsidiaries of A Investments; and
    - In each case following a sale by A Investments, the payment by A Investments of amounts to Mr X.
- SARS further alleged that each arrangement involving the steps listed above is a separate arrangement for purposes of the GAAR, consisting of a set of preconceived transactions which, together, constitute a "scheme".

- Mr X responded to the 80J notice on 22 January 2016 by saying, amongst other things, that he was unable to submit reasons why SARS should not invoke the GAAR against him as the 80J notice was too vague, generalised, and in some places, contradictory.
- Following further correspondence between the parties, SARS raised the additional assessments on 30 August 2016 in terms of the GAAR.
- Mr X objected to the assessments and this objection was disallowed; Mr X then appealed against the assessments to the tax court.
- SARS filed its Rule 31 statement as required. Mr X brought a striking-out application in terms of which it argued that SARS sought to broaden its case in the Rule 31 statement by including significant averments that had not formed part of the assessment. It was alleged that this was not permitted.
- Mr X also argued that the inclusion of these averments in the Rule 31 statement was an attempt to remedy certain shortcomings which had already been identified by Mr X in his objection.
- On the basis that SARS had allegedly pleaded in its Rule 31 statement a basis for exercising its powers under the GAAR that differed from the basis set out in the 80J notice and finalisation of audit letter, Mr X argued that certain paragraphs in the Rule 31 statement should be struck out.
- Stated differently, the argument was that the broadening of SARS' case as suggested by the taxpayer, amounted to a novation of the whole of the factual basis of the disputed assessment, under Rule 31(3) of the rules (Tax Court Rules). The Tax Court Rules were promulgated under section 103 of the Tax Administration Act, 2011 (the TAA).

"Mr X objected to the assessments and this objection was disallowed; Mr X then appealed against the assessments to the tax court."

Mr Y application

The facts involving Mr Y's application are similar to the facts in Mr X's application.

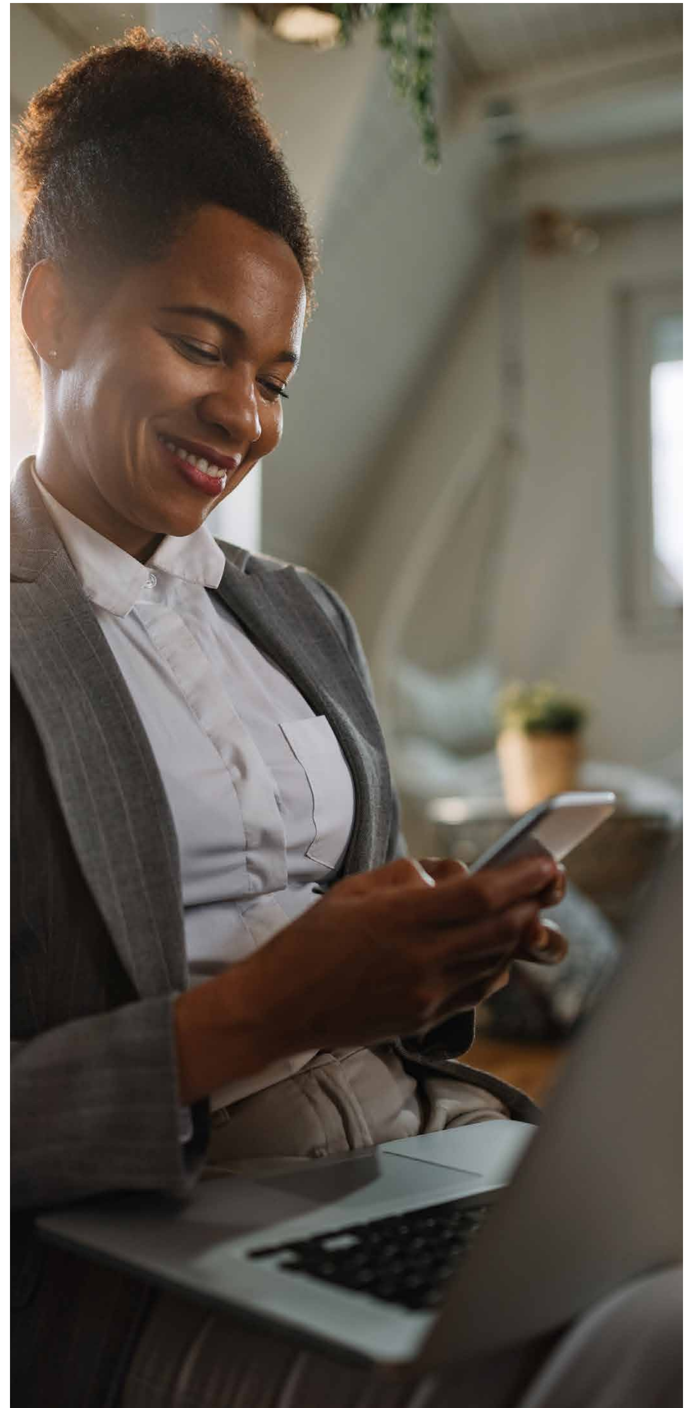
- On 26 October 2015, Mr Y received a notice of audit letter from SARS informing him that an audit would be conducted into his 2006 to 2012 years of assessment.
- On 30 October 2015, SARS issued a letter incorporating both its audit findings and the section 80J notice, indicating amongst other things that the Commissioner intended to invoke the GAAR to raise an additional assessment (the second 80J notice).
- Similar to Mr X's application, Mr Y responded to the second 80J notice that he was unable to advance reasons why SARS should not invoke the GAAR as the second 80J notice was, amongst other things, too vague and generalised, in places contradictory and overall unclear to him.
- As was the case with Mr X, further correspondence was exchanged and SARS ultimately issued an additional assessment to Mr Y, to which he objected and against which he subsequently appealed to the tax court.
- Similar to Mr X's application, the second 80J notice identified three different structures affected by the transactions. These are "the S structure", "the T structure" and "the 2012 structure".
- The second 80J notice states, amongst other things, the following:

  "For the purpose of this analysis, the arrangement or arrangements consist/s of the following:

    - The transactions between A Investments, its subsidiaries and the Isle of Man companies, giving rise to certain A Investments subsidiaries holding promissory notes issued by A Investments:
    - The declaration of certain A Investments promissory notes to J and X;
    - The 'settlement' of the promissory notes held by J and X by means of A Investments becoming obliged to pay those parties the net income from specific transactions involving specific subsidiaries of A Investments;
    - In each case following a sale by A Investments the payment by A Investments of amounts to J and X; and
    - In the specific case of the payments to J, the declaration of dividends by J to its shareholder trusts funded by those payments.

  Each arrangement involving the steps listed above is a separate arrangement for the purpose of the GAAR, consisting of a set of preconceived transactions, which, together, constitute a 'scheme'."

"The tax court held that to determine the merits of the striking-out applications, one had to consider SARS' powers under the GAAR and in this analysis, it was useful to compare the old GAAR provisions as contained in section 103(1) of the Act with the new GAAR provisions."



- Mr Y brought an application on a similar basis to Mr X's application and argued that certain paragraphs in the Rule 31 statement filed in Mr Y's case (second Rule 31 statement) should be struck out.
- On the other hand, SARS brought an application in terms of Rule 51(2) of the Tax Court Rules against Mr X and Mr Y, seeking the tax court to declare that in each appeal, the taxpayers must first adduce evidence at the hearing of the appeals. This was disputed by both taxpayers.

JUDGMENT ON THE STRIKING-OUT APPLICATIONS

Interpretation of the new GAAR

The tax court held that to determine the merits of the striking-out applications, one had to consider SARS' powers under the GAAR and in this analysis, it was useful to compare the old GAAR provisions as contained in section 103(1) of the Act with the new GAAR provisions. The tax court held that when one considers the old GAAR, the basic jurisdictional requirement for the exercise of the powers under that section is that SARS must be "satisfied" of various requirements in section 103(1).

Under the new GAAR contained in sections 80A to 80L of the Act, the requirement that SARS must be satisfied has been specifically excluded. However, the tax court explained that the substantive trigger for the exercise of, or of parts of, the new GAAR, arises where SARS forms an opinion that there is an impermissible avoidance arrangement. For an impermissible avoidance arrangement to exist, the following four requirements must be met:

- First, there must be an "arrangement" as defined in section 80L;
- Second, the arrangement must result in a tax benefit. If the arrangement results in a tax benefit, then it constitutes an "avoidance arrangement";
- Third, the "avoidance arrangement" must have characteristics of abnormality and/or lack commercial substance as set out in sections 80C and 80D; and
- Fourth, the "avoidance arrangement" must have had as its "sole" or "main purpose" the obtaining of a "tax benefit".

The tax court held that to interpret the GAAR, one must adopt the well-known approach set out in *Natal Joint Municipal Pension Fund v Endumeni Municipality*, [2012]. Pursuant to this, the tax court noted that it is clear from the provisions of the new GAAR that the legislature intended a departure from the provisions of the old GAAR, and to this end, specifically excluded as a jurisdictional requirement that SARS must be "satisfied". The tax court held that the judgments relied on by counsel for Mr X and Mr Y, regarding the interpretation of the old GAAR, are not applicable in the present circumstances. An interpretation of the new GAAR sections through the prism of the old GAAR may well have the effect of negating the very purpose of the new sections and the underlying mischief they were intended to address in the first place.

In light of this interpretive approach, the tax court considered whether SARS is, under the new GAAR, permitted to amplify or change the basis of the determination without issuing a fresh assessment. Specifically, this issue revolved around the interpretation of section 80J(4). This section states that if at any stage after issuing a notice in terms of section 80J(1), additional information comes to SARS' knowledge, it may revise or modify its reasons for applying the GAAR or, if the notice has been withdrawn, give notice in terms of section 80J(1). The tax court noted that section 80J(4), as relied on by counsel for Mr X and Mr Y, would only be applicable if there is a jurisdictional fact that is satisfied, namely that additional information must have come to SARS' knowledge.

Application of the law to the facts

The first issue to consider was whether the introduction of certain words in the Rule 31 statements fundamentally altered what was pleaded regarding the impugned "arrangements" or "arrangement" in Mr X's case (the 80J notice and finalisation of audit letter) and in Mr Y's case (the second 80J notice and finalisation of audit letter). The tax court held that the introduction of these words did not alter the basis of the assessment in each case.

The second issue to consider was the argument on behalf of Mr Y that SARS did not allege the receipt of any tax benefit by Mr Y himself in the second 80J notice and finalisation of audit letter. On this issue, the tax court referred to the fact that, amongst other things, the second 80J notice stated that each arrangement factually resulted in a tax benefit for J's shareholder, whereas it was undisputed that the TT Trust was a shareholder of J and Mr Y was a trustee and beneficiary of the TT Trust. The tax court noted SARS' allegation in the second 80J notice that the TT Trust and J are "connected persons" and that the TT Trust and Mr Y are connected persons. It accepted that SARS treated the TT Trust, J and Mr Y as one and the same person, which is permissible in terms of section 80F. As such, the tax court held that there was no novation of SARS' case in the second Rule 31 statement regarding this issue.

Pursuant to the above discussion, the tax court rejected both striking-out applications and ordered that the taxpayers pay SARS' costs in respect of these applications.

Judgment regarding the duty to begin

In answering this question, the tax court indicated that one must first consider Rule 44(1) of the Tax Court Rules, which states that at the hearing of a tax appeal, the proceedings are commenced by the appellant unless –

- the only issue in dispute is whether an estimate under section 95 of the TAA on which the disputed assessment is based, is reasonable or the facts on which an understatement penalty is imposed by SARS under section 221(1); or
- SARS takes a point *in limine*.

While the court held that the cases regarding the interpretation of the old GAAR were not relevant in interpreting the new GAAR provisions, in the context of interpreting the procedural aspect of onus, these cases could be considered. The court then proceeded to consider Rule 39 of the Uniform Rules of Court, which states that the duty to begin follows from the onus of proof.

The tax court held that the question regarding the duty to begin must be determined with reference to who bears the onus to prove the four requirements for an "impermissible avoidance arrangement" as alluded to above. In other words, if SARS relies on the existence of an "avoidance arrangement", it bears the onus of proving it. As the existence of an "avoidance arrangement" is in dispute, SARS must commence leading evidence.

The tax court ultimately found that SARS bore the duty to lead evidence first and ordered SARS to pay the taxpayers' costs in respect of those applications.

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Part IIA (sections 80A to 80L – specifically sections 80A, 80C, 80D, 80F, 80J, 80L (definition of "arrangement")); section 103(1) (prelex text);
- Tax Administration Act 28 of 2011: Sections 95, 103 & 221(1).

Other documents

- Tax Court Rules: Rules 31(3), 44(1) & 51(2);
- Uniform Rules of the Court: Rule 39;
- The Rule 31 statement;
- The second Rule 31 statement;
- The section 80J notice;
- The second section 80J notice.

Cases

- *ITC 1940* [2020] 83 SATC 202;
- *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] (4) SA 593 SCA.

Tags: general anti-avoidance rules (GAAR); impermissible avoidance arrangements; promissory notes; connected persons.

RESTRUCTURING RULES – BINDING PRIVATE RULING 360

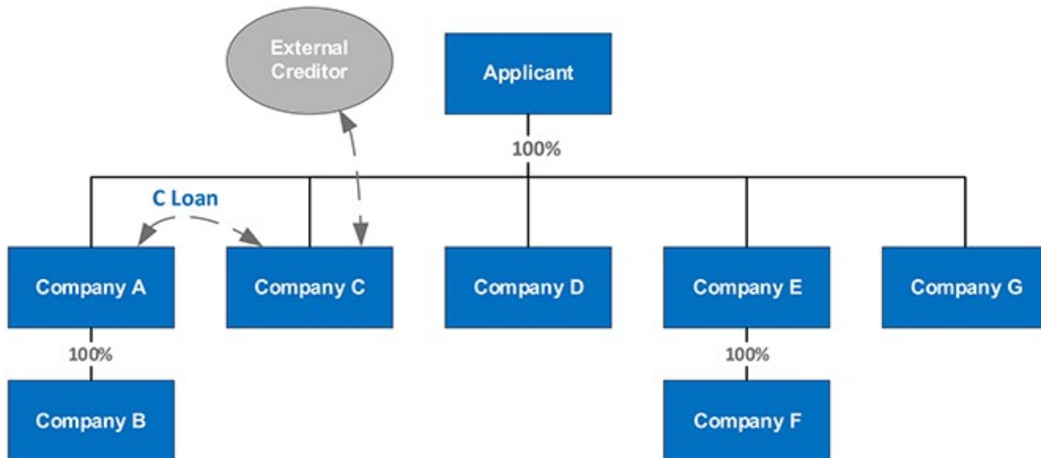
The organic growth of a corporate group can lead to valuable businesses or assets being tucked into hard-to-reach corners. Management or potential investors may also find it most appropriate to only invest in specific parts of a group. Rearranging the ownership structure or establishing where value lies in a corporate group can enable investors to target their investments into parts of the group which are most attractive.

The rollover relief provisions in Part III of Chapter 2 of the Income Tax Act, 1962 (the Act), facilitate the consolidation or division required to appropriately organise a corporate group. These provisions provide mechanisms to conduct intra-group transfers of assets, by deferring the ordinary income and capital gains tax consequences that would otherwise arise from such transfers between distinct taxpayers.

Binding Private Ruling 360 (BPR360) is a good example of the value of flexibility in corporate groups, in enabling targeted investment. Here, a listed holding company (the Applicant) – as part of its B-BBEE initiative and to protect and enhance its commercial position – sought to consolidate certain companies operating in the same sector under an intermediate holding company and to sell a 25% interest in the intermediate holding company to an empowerment investor.

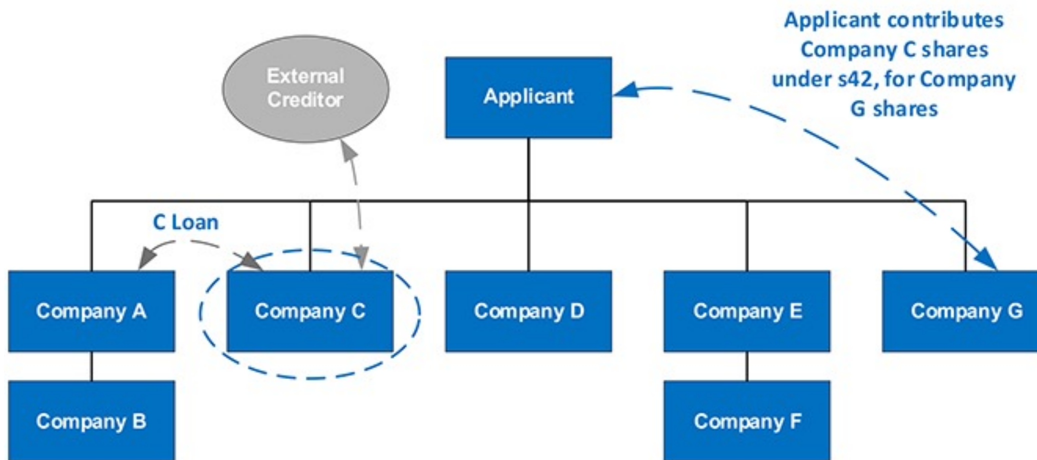
The focus of BPR360 is on the asset-for-share and intra-group transactions consolidating the operating companies under the intermediate holding company, in anticipation of an empowerment investment. Here we will briefly cover how the consolidation was achieved and the specific rulings contained in BPR360.

RATIONALE OF THE TRANSACTION



The Applicant for the purposes of BPR360 owned 100% of five companies directly, two of which each held a 100%-owned subsidiary. The rationale for the transaction was to consolidate Company B and Company C, under Company G. Company G, being the intermediate holding company owning the relevant operating companies, would then be the target of investment by the empowerment investor.

THE SECTION 42 ASSET-FOR-SHARE TRANSACTION



The first step of the transaction would see the Applicant contributing the shares it owned in Company C to Company G, in exchange for shares issued by Company G. This was to be done as an asset-for-share transaction (AFS) under section 42 of the Act.

An AFS meeting the definition in section 42(1) benefits from deferred tax consequences that would otherwise be triggered immediately where an asset is transferred in exchange for the issue of shares. Section 42 applies to deem the transferor and issuer to be one and the same person, as regards the tax characteristics of the asset transferred – including, the date and cost of acquisition. The shares issued are similarly deemed to have been acquired on the same date and for the same expenditure as that for which the asset transferred was initially acquired.

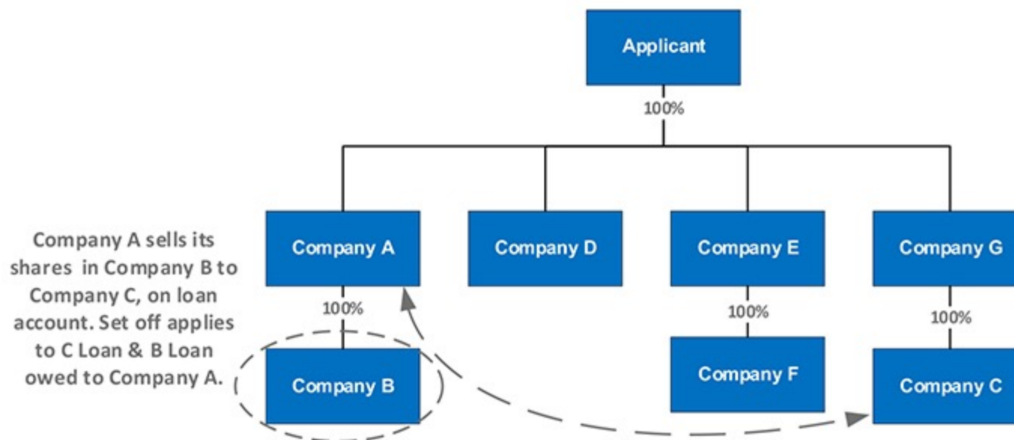
A precursor to the AFS here was to settle outstanding debt owed by Company C to an external creditor, to be funded by the issue of additional shares in Company C. BPR360 ruled that the subscription price for these shares would constitute "contributed tax capital", as defined in section 1(1) of the Act, and expenditure actually incurred as used in paragraph 20(1)*(a)* of the Eighth Schedule to the Act (the Eighth Schedule), for the purposes of determining the shares' base cost. BPR360 states that the contributed tax capital is attributable to the additional shares in Company C.

BPR360 ruled that the AFS was a section 42 transaction. Meaning Company G is deemed to step into the shoes of the Applicant as regards the tax characteristics of the Company C shares and the Applicant would be deemed to have received the Company G shares issued at the same base cost and time as the Applicant initially acquired the Company C shares transferred.

This achieves the first leg of consolidation, with Company G becoming an intermediary holding company of Company C rather than it being held directly by the Applicant.

"BPR360 contains rulings which are important to the successful implementation of the empowerment transaction."

THE SECTION 45 INTRA-GROUP SALE OF COMPANY B



The second step of the consolidation relied on another rollover provision – intra-group transactions under section 45 of the Act. This step saw Company A selling its entire shareholding in Company B to Company C, with the purchase price partially being set off against an existing intra-group loan and the remainder left outstanding as a new intra-group loan.

An intra-group transaction meeting the definition in section 45(1) will also benefit from tax consequence deferrals. Where a resident company disposes of a capital asset to another resident company forming part of the same group of companies, then:

- the transferor company is deemed to have disposed of the asset for an amount equal to the base cost; and
- the transferee company is deemed to have acquired the asset at the same base cost and on the same date as the transferor initially acquired the asset.

BPR360 ruled that the sale of the Company B shares to Company C would constitute a section 45(1)*(a)* intra-group transaction under which Company A is deemed to have disposed of the Company B shares for an amount equal to their base cost. Company C will further be deemed to be one and the same person as Company A as regards the tax characteristics of the Company B shares.

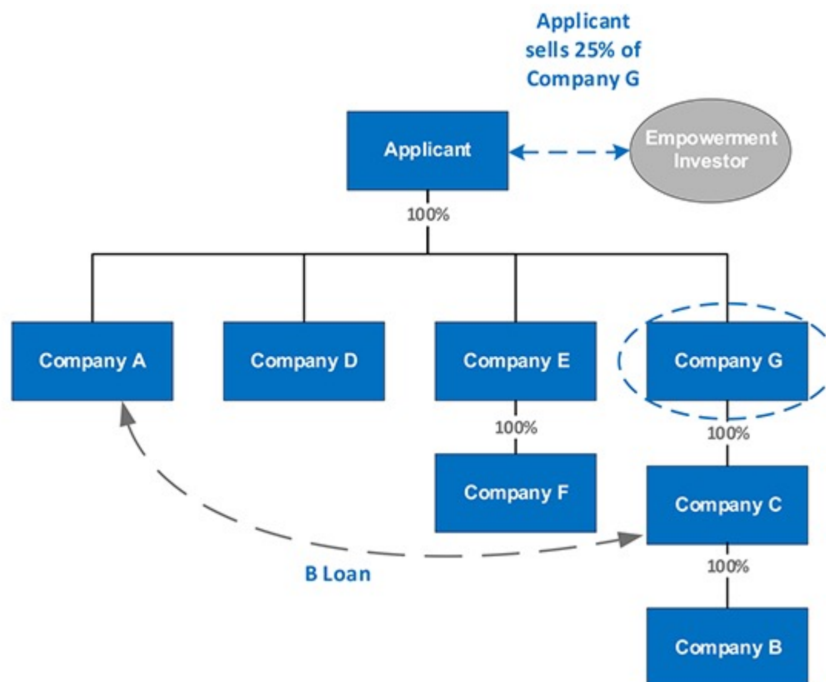
The transaction is funded partially by set-off of a pre-existing loan owed by Company A to Company C and partially by a new loan from Company C to Company A. BPR360 therefore had to rule on the application of section 45(3A)*(b)*(i) and the debt forgiveness provisions in the Act.

BPR360 ruled that with the application of section 45(3A)*(b)*(i), the B loan will be acquired by Company C for nil expenditure and therefore nil base cost. Further, section 45(3A)*(c)* will apply to the set-off and any attendant capital gains or taxable income will be disregarded.

Paragraph 12A of the Eighth Schedule, dealing with concessions or compromise of debt, was similarly ruled to not find application to the set-off caused by this step of the transaction.

Section 45 as a restructuring tool here enables Company A to dispose of a subsidiary to another group company, in a manner which further consolidates the target companies under the intermediate holding of Company G, but without the immediate tax cost which this would otherwise cause. Further, a commercially useful inversion of the debt relationship between Company A and Company C is also achieved, with Company A becoming a creditor of Company C after the implementation of the step.

EMPOWERMENT INTO FINAL STRUCTURE



With the Applicant's corporate group having been appropriately consolidated under the previous steps of the transaction, the empowerment investor is then able to invest into the appropriate part of business held by the Applicant – being the intermediary Company G.

BPR360 contains rulings which are important to the successful implementation of the empowerment transaction. These include rulings that:

- Despite the recent acquisition of Company G shares by the Applicant, the sale of Company G shares to the empowerment investor would be the disposal of a capital asset for the purposes of the Eighth Schedule;
- In determining the base cost of these shares, section 9C(6) would not apply. Rather, paragraph 32(3)(a) of the Eighth Schedule requires each share to have its base cost specifically identified;
- The discount to be applied to the investment by the empowerment partner would not constitute a donation under section 55 of the Act, nor would it be appropriate for the Commissioner to exercise his power under section 58 to adjust the pricing of the transaction as a deemed donation; and
- The de-grouping charge under section 45(4)(b) will not apply to any of the steps of the transaction.

COMMENT

BPR360 provides an excellent example of how agility in the structure of a corporate group can unlock value for potential investors. The rollover relief rules create this agility, by facilitating certain "tax-free" transactions in a group context. These include the transfer of assets – including debt – within a group, the injection of assets into new group companies, the unbundling of a junior subsidiary into a par ranking subsidiary within a listed group, and the winding up and distribution of assets owned by companies which are no longer necessary or useful to the corporate structure.

Cliffe Dekker Hofmeyr

Editorial comment: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, *a binding private ruling* has a binding effect *between SARS and the applicant only,* and is published for general information. It does not constitute a practice generally prevailing. A third party may not rely upon a binding private ruling under any circumstances. In addition, published binding private rulings may not be cited in any dispute with SARS, other than a dispute involving the applicant or any co-applicant(s) identified therein.

Acts and Bills

Income Tax Act 58 of 1962:

- Sections 1(1) (definition of "contributed tax capital") & 9C(6);
- Part III of Chapter 2: Sections 41 to 47 – more specifically sections 42 (including the definition of "asset-for-share transaction" in subsection (1)) & 45(1) (definition of "intra-group transaction"), (3A)*(b)*(i) & *(c)* and (4)*(b)*;
- Sections 55 & 58;
- Eighth Schedule: Paragraphs 12A, 20(1)*(a)* and 32(3)*(a)*.

Other documents

- Binding Private Ruling 360 ("Internal Restructure followed by a disposal of shares in a B-BBEE investor").

Tags: rollover relief provisions; intra-group transfers of assets; Binding Private Ruling 360; asset-for-share transaction (AFS); contributed tax capital; intra-group loan; transferor company; transferee company; intra-group transaction.

SECTION 18A TAX-DEDUCTIBLE DONATIONS

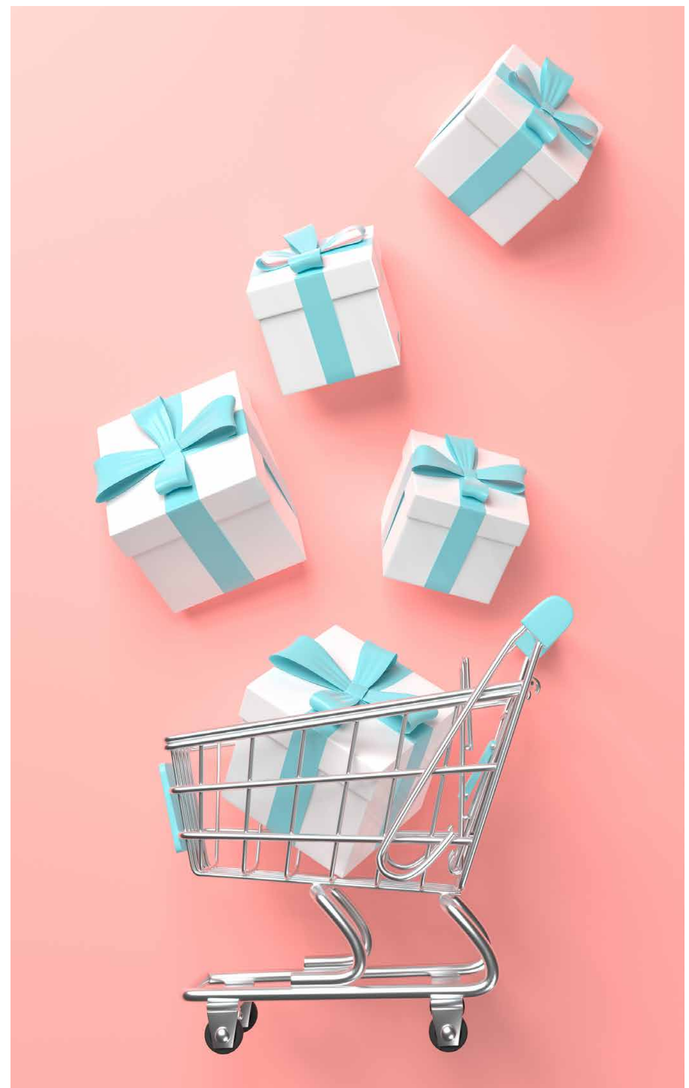
Non-profit organisations (NPOs) play a critical role in their communities and broader society by sharing in the responsibility of Government to pursue the social and developmental needs of South Africa. Certain NPOs can qualify as public benefit organisations (PBOs); this entitles them to a preferential tax regime. Most PBOs are dependent on donor funding and some of them are able to encourage such funding by issuing section 18A tax-deductible receipts which entitle the donors to claim income tax deductions.

In broad terms, entities that can issue section 18A tax-deductible receipts include, amongst others:

- entities that are approved PBOs in terms of section 30 of the Income Tax Act, 1962 (the Act), and which conduct public benefit activities (PBAs) listed in Part II of the Ninth Schedule to the Act (Activities PBOs); and
- entities that are approved PBOs in terms of section 30 and which donate funds or assets to, amongst others, Activities PBOs that conduct activities listed in Part II of the Ninth Schedule (Conduit PBOs).

In recent years, Government has identified certain abuse within the PBO regime and has been increasingly implementing additional tax law amendments and compliance mechanisms for purposes of maintaining the sanctity of the critically important regime. For instance, the Tax Administration Laws Amendment Act, 2020, introduced sanctions in the event that audit certificates (evidencing compliance with section 18A) are not adequately obtained, retained and submitted to SARS by the relevant PBOs.

Following on from this it was announced in the 2021 Budget that SARS has detected that receipts are being issued by entities that are not approved to do so. In this regard, to ensure that only valid donations are claimed and to enhance SARS' ability to pre-populate individuals' returns, it has been proposed that the information required in the section 18A tax-deductible receipts be extended. Furthermore, section 18A-approved PBOs will in future need to comply with SARS third-party reporting mechanisms in respect of the receipts issued. It is clear that PBOs remain under the spotlight and PBOs would be well advised to continuously monitor and keep abreast of developments in this regard.



Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 18A & 30; Ninth Schedule: Part II;
- Tax Administration Laws Amendment Act 24 of 2020.

Tags: non-profit organisations (NPOs); public benefit organisations (PBOs); section 18A tax-deductible receipts; audit certificates.

FOUNDER SHARES AND SECTION 8C

Founders of businesses will usually inject large amounts of intellectual capital into their ventures apart from economic capital from banks and seed capital from investment pundits. Tax is hardly a consideration at the commencement stage of a business venture and, if it is, the dream of capital growth is usually equated to a capital gains tax liability at some future date.

Not only will the founder of the business be a shareholder in the investment vehicle having injected limited economic capital, but the founder will usually also be a director of the company. Could the directorship cause the founder's shareholder interest to be tainted with an employees' tax exposure? Could a disposal among co-founders who are directors of the investment vehicle be taxed in a way other than qua shareholder?

The conundrum lies in the infamous section 8C of the Income Tax Act, 1962, the law that taxes so-called "restricted equity instruments" which are acquired "by virtue of his or her employment or office of director of any company". The effect of these rules is to subject otherwise capital gains to income tax, and to defer the tax event until the said restrictions cease to have effect or the instrument is disposed of. If the share value grows, the amount subject to income tax at the later date is higher.

But the provisions go one step further and seek to bring within the net a "restricted equity instrument" acquired during the period of his or her employment by any company or office of director of that company from either:

- that company;
- a related company; or
- any person employed by or that is a director of that company or a related company.

The key requirement for this element of the section to apply is that the instrument must be "restricted". This is defined to mean many things, but is primarily focused on restrictions from transferability at market value as well as forfeiture restrictions other than at market value. There is no requirement that the instrument had to be acquired by virtue of employment. An objective test is applicable in this instance which includes a determination whether the shares were acquired after the person had become an employee or director.

In a founder business, where the founder is also a director, the seed funder may require the founders to be locked in to the business in such a way that the transferability of their shares is restricted for a period of time. This may cause the shares to be "restricted" and on the face of it, the shares may constitute "restricted equity instruments", subject to employees' tax. Not only could the founder who subscribes for the shares be subject to section 8C, but also the transferee of the shares who acquires the shares from the founder, provided that both are either directors or employees of the company whose shares are transferred.

Albeit that this provision of section 8C was meant to deal with anti-avoidance considerations relating to employment shares, the wording may cause so-called founder shares to be caught within the income tax net.

"Accordingly, consideration must be given to restrictions imposed on founder shares in shareholders agreements and incorporation documents so as not to be met with an employees' tax liability."

Accordingly, consideration must be given to restrictions imposed on founder shares in shareholders agreements and incorporation documents so as not to be met with an employees' tax liability. Furthermore, consideration should be given to the timing of the introduction of shareholder restrictions as well as contracts of employment and directorship arrangements in order to assess the application of the section.

Bowmans

Acts and Bills

- Income Tax Act 58 of 1962: Section 8C.

Tags: restricted equity instruments; related company.

DIVIDEND PAYMENT CYCLES

The negative economic impact of the global Covid-19 pandemic has been widespread and has led to a number of adverse outcomes. In the listed equity sector, the non-declaration of dividends or the postponement and/or the cancellation of dividends, which was once a rare occurrence, has become more prevalent.

Although dividends declared by a South African resident company may qualify for the domestic exemption from income tax in terms of the Income Tax Act, 1962, certain dividends do not qualify for this exemption and are ultimately taxable in the shareholder's hands. For example, dividends declared by South African REITS are not exempt in the hands of South African residents. Dividends received by parties who have entered into specific transactions over South African listed shares such as derivatives, share loans and collateral transfers may also not qualify, either fully or partially, for the domestic dividend exemption.

The postponement and/or cancellation of dividend payments may result in tax implications for taxpayers which differ from the overall economic outcome. A high-level overview of certain South African tax considerations to be borne in mind in respect of taxable (ie, non-exempt) dividends in respect of listed shares issued by South African resident companies is set out below.

BACKGROUND

South African tax resident and non-resident persons are required to include dividends received or accrued in respect of shares issued by South African resident companies in their gross income.

From a timing perspective, the full amount of the dividend will be included in the gross income of the relevant shareholder, and therefore taken into account for income tax purposes, upon earlier receipt or accrual thereof. In the context of listed shares, dividends declared in respect thereof will be seen to "accrue", for tax purposes, to the persons who are identified as a shareholder on the dividend record date. Since the actual payment of dividends is effected after the record date, the dividend record date is generally the date on which the dividend is to be taken into account for tax purposes.

As set out above, the dividends which are under consideration are those which do not qualify for the domestic dividend exemption.

POSTPONEMENT OF DIVIDEND PAYMENT

Where a dividend is declared and the payment date thereof is subsequently postponed, the shareholder on the record date will be required to include the amount of the dividend in its gross income, regardless of when payment of the dividend is actually made.

A scenario could arise where the timing delay between the accrual date and the postponed payment date of a dividend is such that the date of accrual (ie, the record date) falls in a particular year of assessment and the postponed payment date falls in a subsequent year of assessment. Since the dividend is not exempt from tax, the impact thereof could simply be that a person holding the shares may be required to fund the amount of tax payable in respect of the taxable dividend without having received actual payment thereof.

"This is further complicated by the fact that provisional taxpayers are required to submit provisional tax payments based on an estimate of taxable income every six months and in each case a judgement will need to be made as to whether there is a reasonable expectation that the dividend will be paid in a particular year of assessment or not.

However, the impact may be wider in the context of the postponement of a dividend payment date in respect of transactions such as derivatives, share loans and collateral transfers entered into in respect of South African listed shares. In terms of these transactions, the person who is entitled to the dividend may be required to make derivative or other related payments to a transaction counterparty, which payment may take into account the dividend in respect of the underlying share.

Where the date of accrual of the dividend falls in a particular year of assessment and the postponed payment date falls in a subsequent year of assessment, the shareholder on the record date may only be permitted a deduction of the derivative or related payment in the subsequent year of assessment, depending on aspects such as the terms of the transaction concluded by the parties. This could lead to a scenario where a party is required to account for and make payment of income tax on the gross taxable dividend in a year of assessment, only to be permitted the relevant deduction in a subsequent year of assessment.

This is further complicated by the fact that provisional taxpayers are required to submit provisional tax payments based on an estimate of taxable income every six months and in each case a judgement will need to be made as to whether there is a reasonable expectation that the dividend will be paid in a particular year of assessment or not.

CANCELLATION OF DIVIDENDS

The cancellation of a dividend which has been declared may require careful consideration, in particular, where the cancellation occurs after the dividend record date. This is on the basis that, as set out above, the shareholder on the record date will be required to include the amount of the dividend in its gross income.

If a dividend payment is postponed and then subsequently cancelled, the economic impact for the relevant shareholder on the record date is that the dividend is simply never received. However, from a tax perspective, the accrual of the dividend takes place on the record date, regardless of any potential future cancellation thereof.

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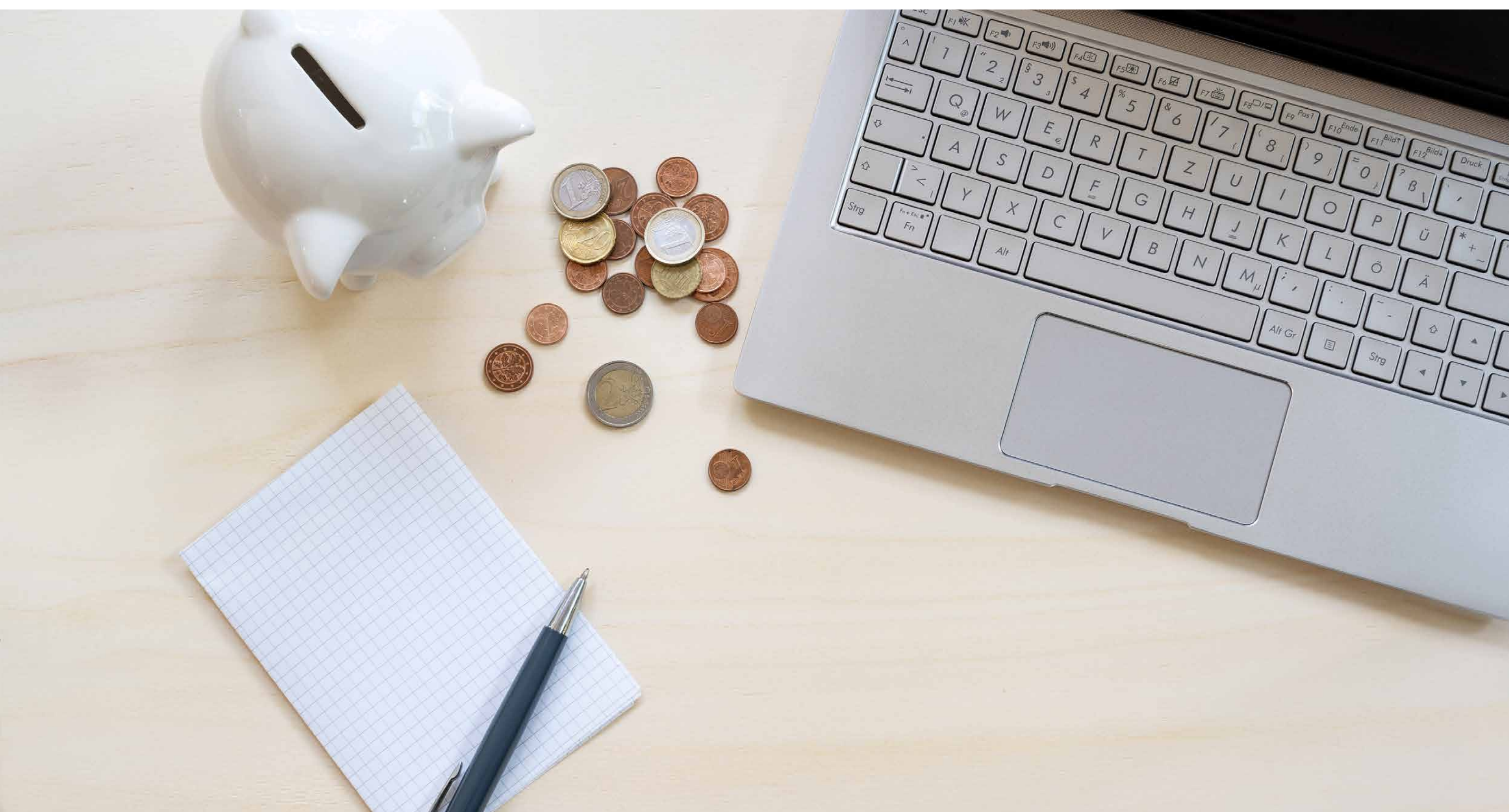
Acts and Bills

- Income Tax Act 58 of 1962.

Tags: taxable dividend; dividend payment date; provisional taxpayers; record date.



ANNUITISATION OF PROVIDENT FUNDS

From 1 March 2021, members of provident funds on retirement have to buy an annuity with two-thirds of their retirement funding, bringing them in line with pension and retirement annuity (RA) fund members.

The mandatory annuitisation of provident funds, which was first proposed in 2013 in the Taxation Laws Amendment Bill, 2013 (the 2013 Bill), finally became a reality from 1 March 2021 after an historic agreement with all Nedlac constituencies.

Previously, only pension fund and RA fund members were required to annuitise two-thirds of their retirement interest upon retirement. This applied unless a member's interest in a retirement fund was less than R247 500, where the full amount could be withdrawn as a lump sum on retirement.

The Explanatory Memorandum that accompanied the 2013 Bill suggested that a "strong link" existed between the inadequate retirement funds held by members of provident funds after their retirement and lump sum pay-outs to provident members on retirement.

The purpose of the change was to ensure that provident fund members had a secure source of income during retirement and that retirement interests were not depleted too quickly. Significantly, it was also to harmonise the treatment of the three different forms of retirement funds in South Africa, namely pension funds, provident funds and RA funds.

Labour unions initially challenged the proposed compulsory annuitisation of provident funds. It was also later noted, during the Standing and Select Committees on Finance's discussion on the Revenue Laws Amendment Bill, 2016, that a misconception arose that the proposal to annuitise provident funds was an attempt by the government to nationalise provident funds.

Consequently, the implementation of the mandatory annuitisation of two-thirds of provident fund pay-outs on retirement was postponed multiple times, until it was finally announced in Parliament in 2020 that the change would be effective from 1 March 2021. This was confirmed by Finance Minister Tito Mboweni during the 2021 Budget Speech.

IMPACT

With effect from 1 March 2021, and subject to certain conditions and provisos, no more than one-third of the total value of a member's interest in a provident fund may be commuted for a single, lump sum payment and the remainder must be annuitised.

This general rule will not apply where two-thirds of the total value of a member's interest does not exceed R165 000, the member is deceased or the interest is transferring to a preservation or RA fund.

The general rule is subject to several provisos, including that the interest held by provident fund and provident preservation fund members who are 55 or older on 1 March 2021 will be unaffected. Their additional contributions and fund returns will also be unaffected by the amendment.

In any other case, the interest and fund returns of members of provident funds or provident preservation funds who were members on or before 1 March 2021 will be unaffected by the change, as will additional amounts credited. Only contributions made from 1 March 2021 will be affected by the general rule.

The implementation of the mandatory annuitisation of two-thirds of provident fund pay-outs on retirement (ie, the general rule discussed above) forms part of government's plan to ensure that provident fund and provident preservation fund members access their retirement funds sustainably and is to be welcomed. However, the significant and, in our view, unnecessary delay in its commencement means that a number of people may have withdrawn and spent their investment in full in the intervening period.

Webber Wentzel

Acts and Bills

- Taxation Laws Amendment Bill 39 of 2013;
- Revenue Laws Amendment Bill 4B of 2016.

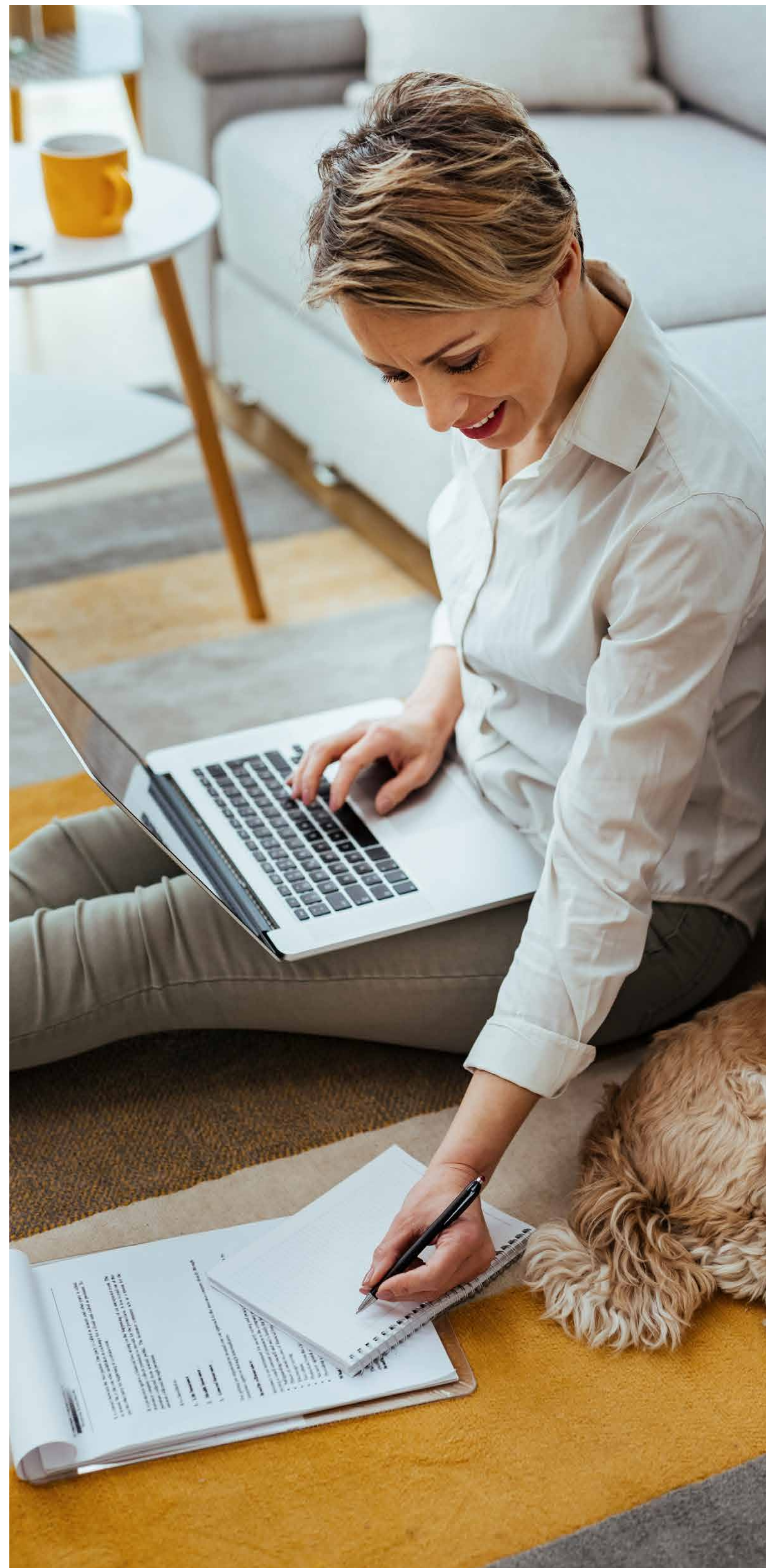
Other documents

- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013.

Tags: retirement annuity fund; annuitisation of provident funds; pension fund; provident fund; provident preservation fund.

JUSTIFICATION FOR SARS' DELAY DURING LOCKDOWN?

In ITC 1938 [2020], the tax court had to determine whether the taxpayer was entitled to default judgment against the South African Revenue Service (SARS). In terms of Rule 56 of the dispute resolution rules (Tax Court Rules) promulgated in terms of section 103 of the Tax Administration Act, 2011 (the TAA), default can be obtained in certain circumstances. Of particular importance in this case was the determination as to whether a taxpayer has a viable remedy in the event that SARS fails to comply with an order of court that was previously handed down.



FACTS

The facts and litigious history of this matter are complicated and, as was astutely described by the court, they are "long, tortuous and extremely unfortunate".

In August 2000, the applicant in this matter (the Applicant) and the Minister of Correctional Services concluded a concession contract in terms of which the Applicant was contracted to design, construct and operate a correctional facility. The term of the agreement was 25 years, at the expiration of which the correctional facility was to be handed over to the state.

The first of many disputes between the Applicant and SARS arose in respect of the Applicant's tax return for the 2002 year of assessment, which dispute was ultimately decided by the Supreme Court of Appeal in 2011. The second dispute arose in relation to the assessments that were raised by SARS in 2015 in respect of the Applicant's 2005 to 2012 years of assessment. Whilst this dispute proceeded, SARS issued assessments in respect of the Applicant's 2013 and 2014 years of assessment, which assessments were raised on identical grounds as those in respect of the prior years of assessment.

The identical letters of objection lodged by the Applicant in respect of each year of assessment contended that the amounts "added back" by SARS constituted income of a capital nature rather than of a revenue nature, and as such should not be included in the taxable income of the Applicant. The Applicant also objected to SARS' disallowance and reversal of an exemption that was previously granted to the Applicant.

After the disallowance of its objections, the Applicant lodged an appeal in respect of the assessments for the 2005 to 2012 years of assessment on 31 January 2017. Notwithstanding various delays, it was agreed that SARS would file its opposing statement by 17 June 2017. After failing to meet this deadline, SARS was granted an extension for the filing of the opposing statement to 14 July 2017. This deadline was also not complied with by SARS.

In response, the Applicant gave notice that, unless SARS filed its opposing statement within 15 days, the Applicant would apply for a default order against SARS, in terms of which the original assessments issued by SARS would be revised and reduced in accordance with the terms of the Applicant's notice of appeal. SARS did not file its opposing statement until approximately a month after the 15 days' deadline and also did not file an answering affidavit in respect of the Applicant's application for a default order by the prescribed date. As such, the Applicant requested that a date for the hearing of the application by default be allocated.

The Rule 56 application was heard by the tax court, which concluded that SARS had "made itself guilty of an egregious breach of the Tax Rules", as a result of which default judgment was granted in favour of the Applicant in respect of the 2005 to 2012 years of assessment.

"The Rule 56 application was heard by the tax court, which concluded that SARS had "made itself guilty of an egregious breach of the Tax Rules", as a result of which default judgment was granted in favour of the Applicant in respect of the 2005 to 2012 years of assessment."

The dispute between the Applicant and SARS in respect of the Applicant's 2013 and 2014 years of assessment then came before the tax court, which court dismissed the application on the grounds that the Applicant's objections were invalid. This decision of the tax court was appealed to the Full Bench of the High Court in January 2020, which court gave an order in the following terms:

(1) SARS would come to a decision regarding the allowance or disallowance of the Applicant's objections and would provide the Applicant with the basis of the said decision within 60 days of the court order; and

(2) In the event that SARS failed to make the decision and provide the grounds for that decision within 60 days, the Applicant would be entitled to make an application in terms of Rule 56(2)*(b)* of the Tax Court Rules for a final order that the tax court deems appropriate.

SARS failed to notify the Applicant of its decision to allow or disallow the Applicant's objection within 60 days of the court order. As such, the Applicant (on the strength of the order of the High Court) approached the tax court seeking to invoke Rule 56 in support of its application for default judgment.

JUDGMENT

It was the Applicant's contention that SARS had failed to comply with the order of the High Court as it had communicated its decision, on whether or not the Applicant's objection would be allowed, more than two months out of time. As a result, the Applicant submitted that the tax court was empowered to grant default judgment in favour of the Applicant in terms of Rule 56 and section 129(2)*(b)* of the TAA.

Rule 56 provides that if a party to a proceeding fails to comply with a prescribed time period or obligation, the other party may deliver a notice to the defaulting party informing them of their intention to

apply for a final order in terms of section 129(2). The notice must state that the defaulting party has 15 days to remedy the default. To the extent that the default is not remedied within the 15-day period, the aggrieved party may apply to the tax court, which is empowered –

(i) in the absence of good cause shown by the defaulting party for the default in issue, to make an order in terms of section 129(2); or

(ii) to make an order compelling the defaulting party to comply with the obligation, failing which it can make an order in terms of section 129(2) without further notice to the defaulting party.

Section 129(2) provides that, in the case of an assessment or "decision" under appeal, or an application in a procedural matter referred to in section 117(3), the tax court may –

(a) confirm the assessment or "decision";

(b) order the assessment or "decision" to be altered; or

(c) refer the assessment back to SARS for further examination and assessment.

In support of its case, the Applicant addressed SARS' reasons for defaulting on the order of the High Court. It was submitted that the said reasons were entirely unsatisfactory, as a result of which the tax court would be justified in granting an order in terms of section 129(2) on the basis that SARS was unable to show good cause for its default.

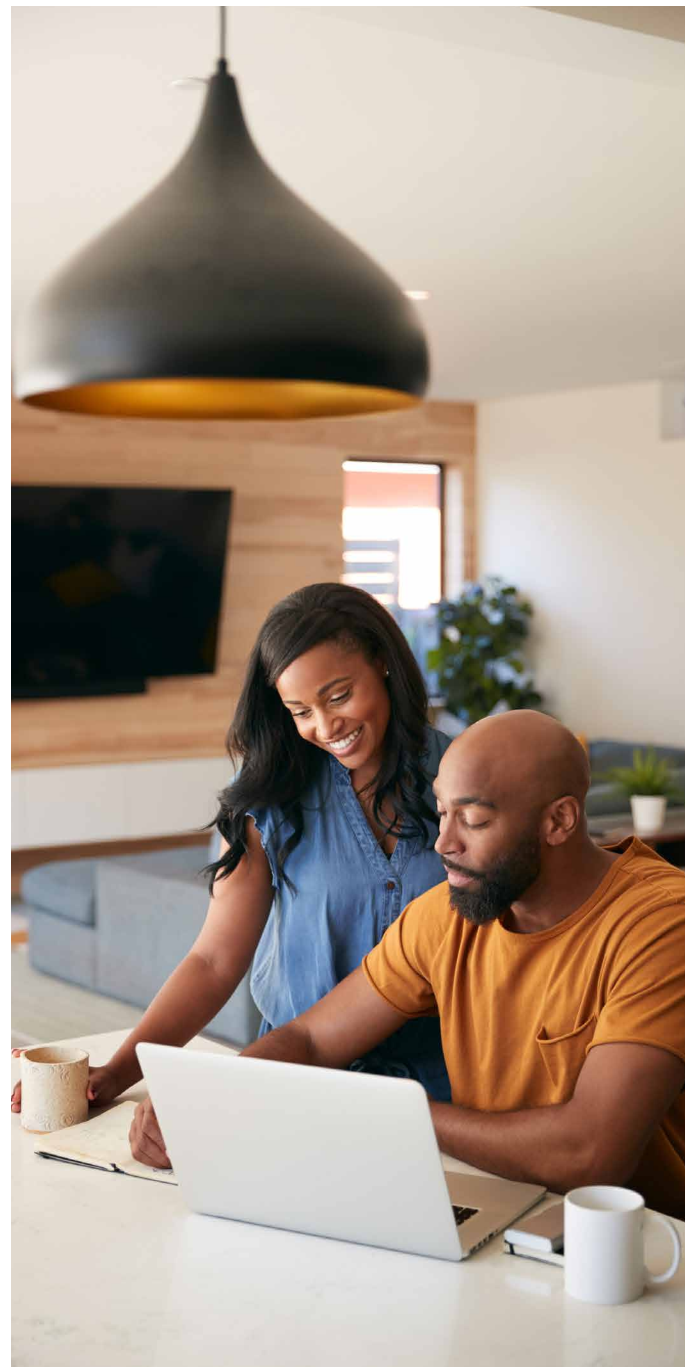
In its opposition to the application, SARS raised the issue of the administrative nature of an assessment issued by it and argued that until such time as the assessment has been set aside, it is a valid and binding decision. The tax court inferred that SARS was relying on the principles laid out in the Supreme Court of Appeal (SCA) judgment of *Oudekraal Estates (Pty) Ltd v City of Cape Town*, [2004] (the *Oudekraal Estates* case), which were summarised by the tax court as follows:

(1) administrative action that is invalid can give rise to consequences that must be regarded as lawful until such time as the validity of that administrative action has been tested in appropriate legal proceedings before a court; and

(2) allegedly unlawful administrative action can only be challenged in properly constituted proceedings before a court and until that happens, in order to adhere to the principle of the rule of law, the decision must stand.

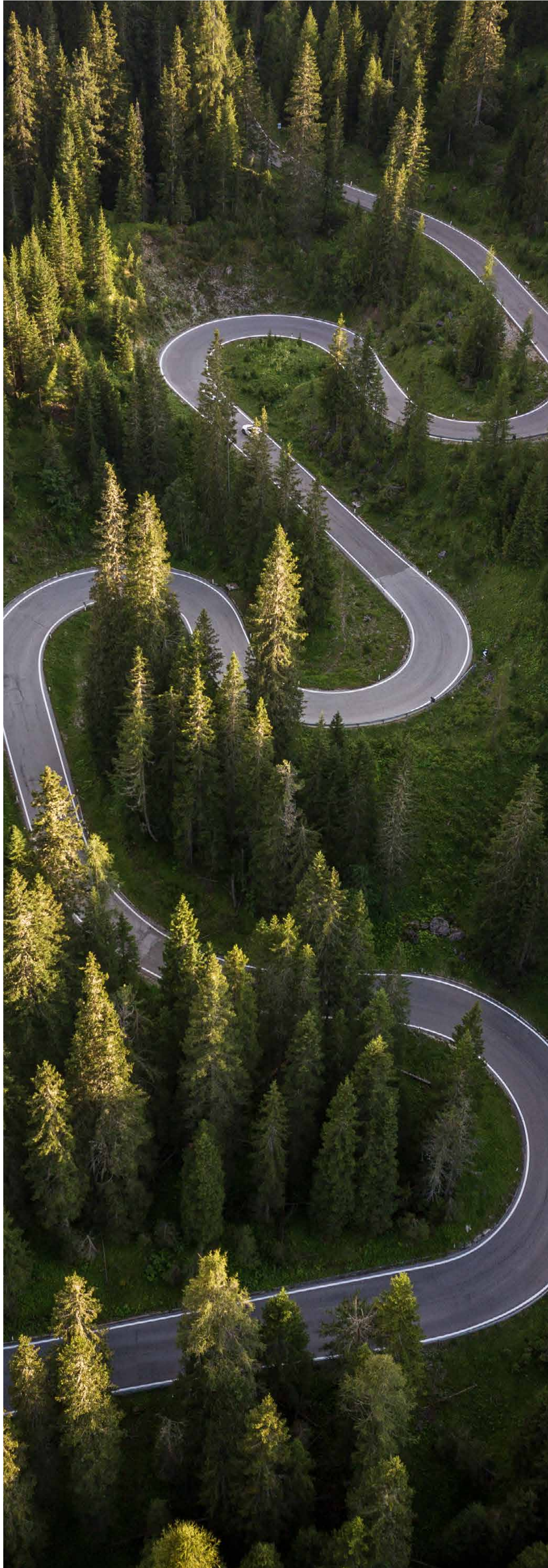
The tax court ruled that the application brought by the Applicant (although unconventional) constituted the type of appropriate legal proceedings before a court that was envisaged by the SCA in the *Oudekraal Estates* case when determining the necessary forum for the challenge of unlawful administrative action. As such, it was held that the proceedings before the tax court were capable of setting aside an invalid administrative act taken by SARS, which would include the decision by SARS to disallow the Applicant's objection.

In this case, the legal basis in terms of which SARS' decision was to be set aside was Rule 56, which provides the tax court with a discretion in determining whether an order in terms of section 129(2) should be granted. However, in coming to its decision, the tax court found that it could not exercise its discretion in favour of the Applicant for two reasons.



Firstly, SARS had contended that one of the reasons for its delay in complying with the High Court's order was the negative impact that the national lockdown, caused by the Covid-19 pandemic, had on SARS' administration and operations. The tax court conceded that this explanation given by SARS for its default constituted "good cause" for the delays that it had caused.

Secondly, neither of the parties before the tax court presented arguments pertaining to the merits of the case, as a result of which the court was unable to make a pronouncement on the success or failure of the Applicant's objection to SARS' assessments for the 2013 and 2014 years of assessment.



"However, in taking cognisance of SARS' "dilatory and utterly disrespectful" approach to the dispute proceedings between it and the Applicant, the court granted a punitive cost order against SARS."

In the result, the court dismissed the application for the default order that was sought by the Applicant. However, in taking cognisance of SARS' "dilatory and utterly disrespectful" approach to the dispute proceedings between it and the Applicant, the court granted a punitive cost order against SARS.

COMMENT

Rule 56 makes provision for a default order to be granted against either SARS or a taxpayer in the event that the time periods and obligations imposed by the TAA are not adhered to. This type of relief may prove very beneficial to a taxpayer, provided that they can prove that the failure by SARS to comply with its obligations cannot be justified. In this case, it is likely that the Applicant would have been granted the default order had the Covid-19 pandemic not had such a significant impact on the proper functioning of the South African economy as a whole.

However, it is worth noting that when a default order is denied, a taxpayer is not without further remedies as the taxpayer is still entitled to approach the tax court to have the merits of its case properly ventilated. To the extent that the taxpayer's arguments have merit, it may be successful in the tax court and, as pointed out by the court in this case, the taxpayer may be entitled to a punitive cost order.

Interestingly, this case appears to be one of the first tax court cases to expressly deal with the collateral challenge issue. A collateral challenge may be used to test the validity of an administrative act and "will generally arise where the subject is sought to be coerced by a public authority into compliance with an unlawful administrative act" (para 32 of the *Oudekraal Estates* case).

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 103, 117(3) and 129(2).

Other documents

- Tax Court Rules: Rule 56.

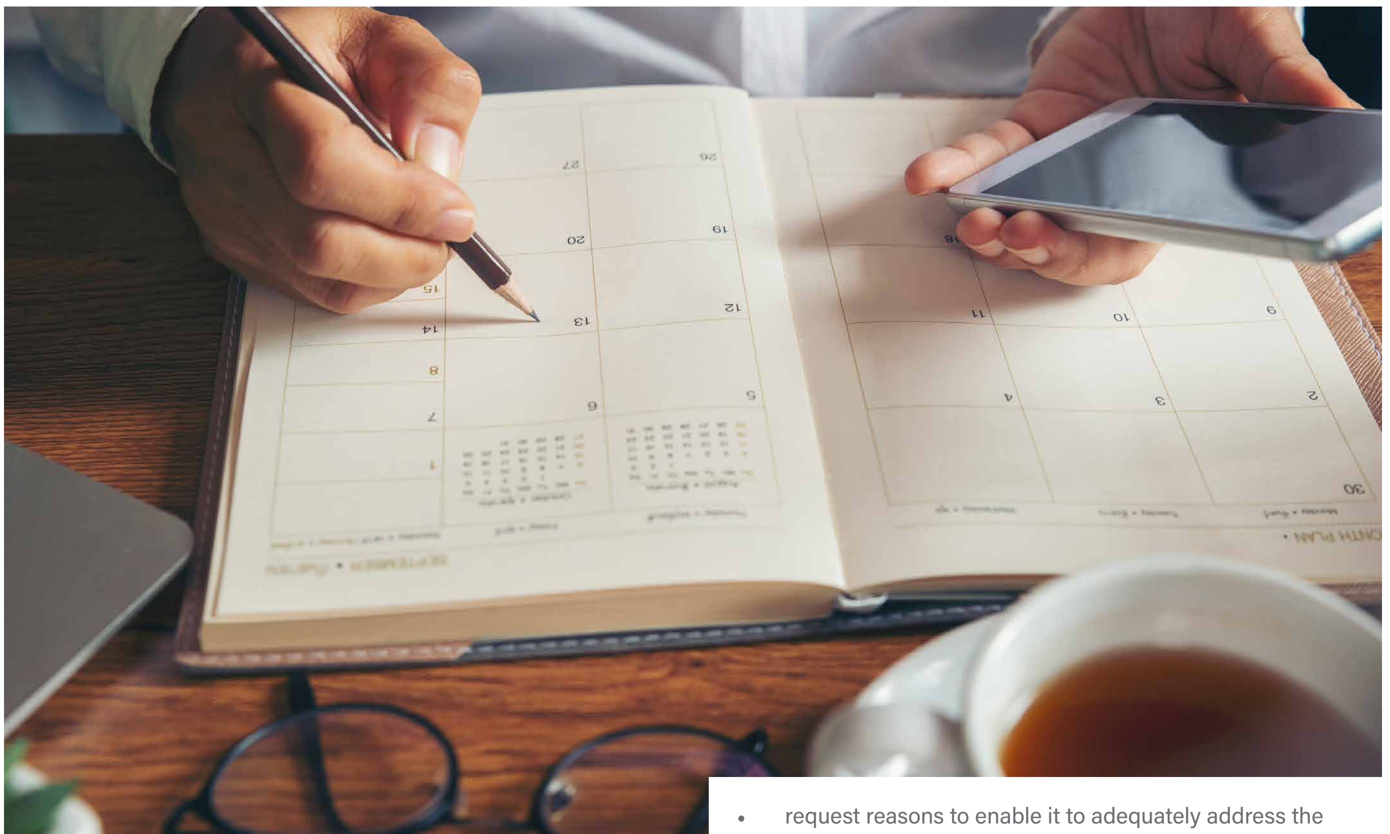
Cases

- *Oudekraal Estates (Pty) Ltd v City of Cape Town and Others* [2004] (6) SA 222 SCA (para 32);
- *ITC 1938* [2020] 83 SATC 145.

Tags: letters of objection; administrative action; default order; collateral challenge.

LATE FILING OF OBJECTIONS

In a fiscal environment, where the "coffers" are running on low reserves and National Treasury, together with the South African Revenue Service (SARS), are pursuing taxpayers who have not paid their dues, entering into a tax dispute with SARS is something most taxpayers would like to avoid.



However, should taxpayers find themselves in a scenario where it is necessary to engage SARS, either to dispute a tax liability allegedly owed or to rectify a mistake made by SARS, there is a framework available to taxpayers which provides guidance as to how to engage SARS and importantly, the timelines within which taxpayers must do so.

This framework is contained in Chapter 9 of the Tax Administration Act, 2011 (the TAA), and the rules promulgated under section 103 of the TAA (the Rules). The Rules allow taxpayers to engage SARS when aggrieved by an assessment or not satisfied with a decision taken by SARS; if the decision is subject to objection and appeal, they have a right to dispute the assessment or decision.

Briefly, the dispute resolution process in terms of the Rules, read together with the Act, provides that after having received a notice of assessment from SARS, the taxpayer may:

- request reasons to enable it to adequately address the basis of the assessment to the extent that the grounds of assessment are not sufficiently clear;
- file a notice of objection against the grounds of assessment which SARS will consider and either disallow or allow in whole or in part;
- lodge a notice of appeal if the taxpayer is dissatisfied with SARS' decision following the objection; and
- resolve the dispute either through alternative dispute resolution process or by approaching the Tax Board or the tax court.

It is important to note that each of the above-mentioned steps has prescribed time periods to which the taxpayer (and SARS) must adhere in order to avoid additional steps, such as applying for condonation for late filing and/or requesting an extension of time within which to comply with the prescribed time periods.

The judgment discussed in this article specifically discusses the consequences for non-compliance with the prescribed time period (further discussed below) within which to lodge a notice of objection.

TAX COURT JUDGMENT

In the tax court judgment of *ABC (Pty) Ltd v Commissioner of the South African Revenue Service*, [2020] (as yet unreported), the court provided a reminder to taxpayers as to the importance of adhering to the Rules and, most importantly, complying with the prescribed time periods set out in the Rules.

In this matter, the court had to consider a taxpayer's application for condonation in relation to the late filing of its notices of objection to three notices of assessment received for the tax years of assessment 2014, 2015 and 2016, totalling R33 943 594.99 in assessed tax.

The notices of objection fell well outside the time periods allowed in terms of the Rules for filing such notices:

- the 2014 notice was 679 days out of time;
- the 2015 notice was 641 days out of time; and
- the 2016 notice was 395 days out of time.

The Rules provide that a notice of objection must be filed within 30 days of receiving the assessment (or after having received reasons for the assessment after having requested them). If a taxpayer is late in filing a notice of objection, the taxpayer must request condonation from SARS and an extension in which to lodge the notice of objection – which extension may not be more than 30 additional days unless a senior SARS official deems that exceptional circumstances exist.

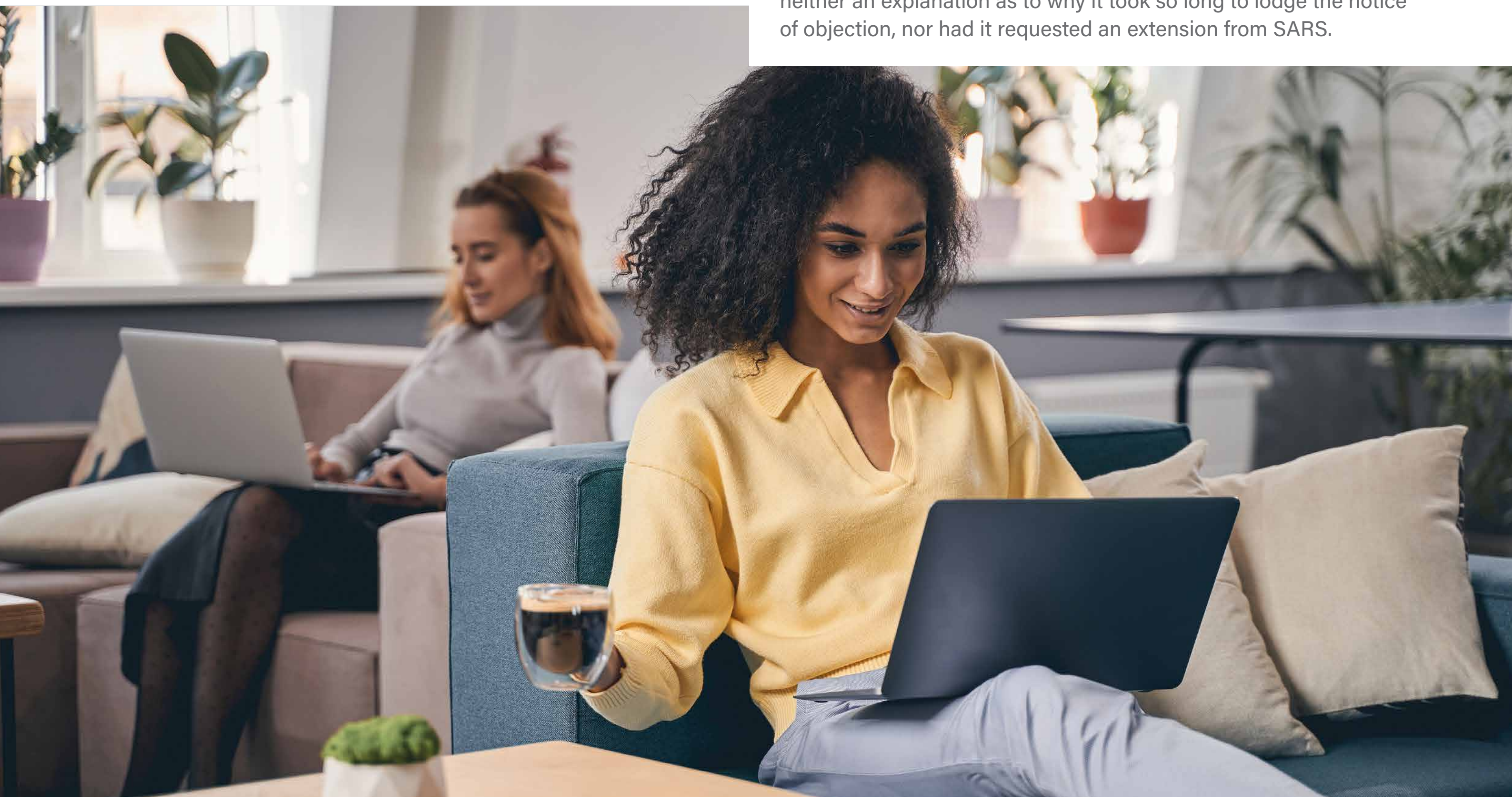
"However, in taking cognisance of SARS' "dilatory and utterly disrespectful" approach to the dispute proceedings between it and the Applicant, the court granted a punitive cost order against SARS."

In considering whether such exceptional circumstances exist, SARS has issued Interpretation Note 15 (IN15) dealing with "Exercise of discretion in case of late objection or appeal". IN15 is not binding, but lists the factors which SARS would potentially consider when exercising its discretion in granting condonation for late filing and providing the taxpayer with an extension, namely:

- reasons for delay;
- length of the delay;
- prospects of success on the merits; and
- other relevant issues, eg, SARS' interest in the determination of the final tax liability in view of the broader public interest relating to budgeting and fiscal planning.

Therefore, in order to succeed, the taxpayer had to provide a full and detailed account of the cause(s) for its failure to comply with the prescribed time to allow the court to assess the cause of the delay and make a determination as to the responsibility for the delay.

The taxpayer in this instance simply lodged the objection, failing to apply for an extension of the time period prescribed, and also did not make out a case for condonation. The taxpayer provided neither an explanation as to why it took so long to lodge the notice of objection, nor had it requested an extension from SARS.



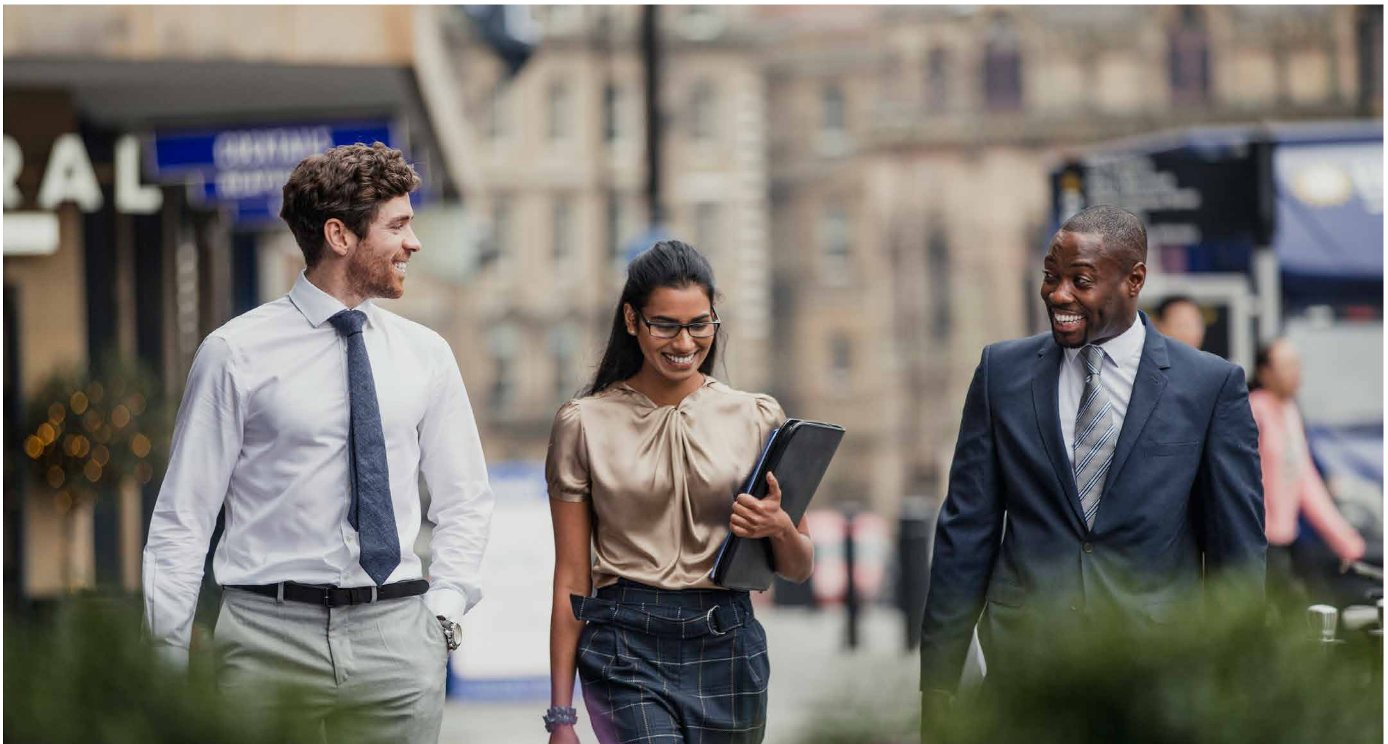
In this matter, the court held that the taxpayer's failure to explain its delay was fatal to the application and the lengthy period of the delay exacerbated the issue. The court stated that SARS cannot be expected to endure an unexplained delay of such a lengthy period especially in light of the fact that the notice of objection (which was eventually submitted) did not contain any details in respect of the merits of the applicant's case.

The taxpayer further provided no details as to why its prospects of success were strong and merely included the entire notice of objection without explaining why it bears any merit. The taxpayer's notice of objection also did not explain why SARS' assessments were incorrect and only stated that its objection enjoyed a strong prospect of success, without giving any details. The court stated that "this is simply inadequate" and reminded the taxpayer that in order to succeed with an application of this nature, the taxpayer bears the onus of showing that its case enjoys such a strong prospect of success that the court should, in the interest of justice, condone its failure to abide by the prescribed time periods for the lodging of its objection. The taxpayer failed to do so in this matter.

The court accordingly dismissed the taxpayer's application and showed its disdain for the taxpayer's disregard for the Rules by making an adverse cost order against the taxpayer.

OBSERVATION

This case demonstrates how imperative it is for taxpayers to keep abreast of their tax obligations to SARS and, further, to be mindful of the time periods within which they have to dispute decisions made by SARS concerning their tax affairs. It is always strongly advisable to appoint an experienced tax practitioner to obtain the most expeditious and favourable outcome for the taxpayer and failing to do so may result in a years-long dispute costing many millions of rands.



Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Chapter 9 (sections 101 to 150; more specifically section 103).

Other documents

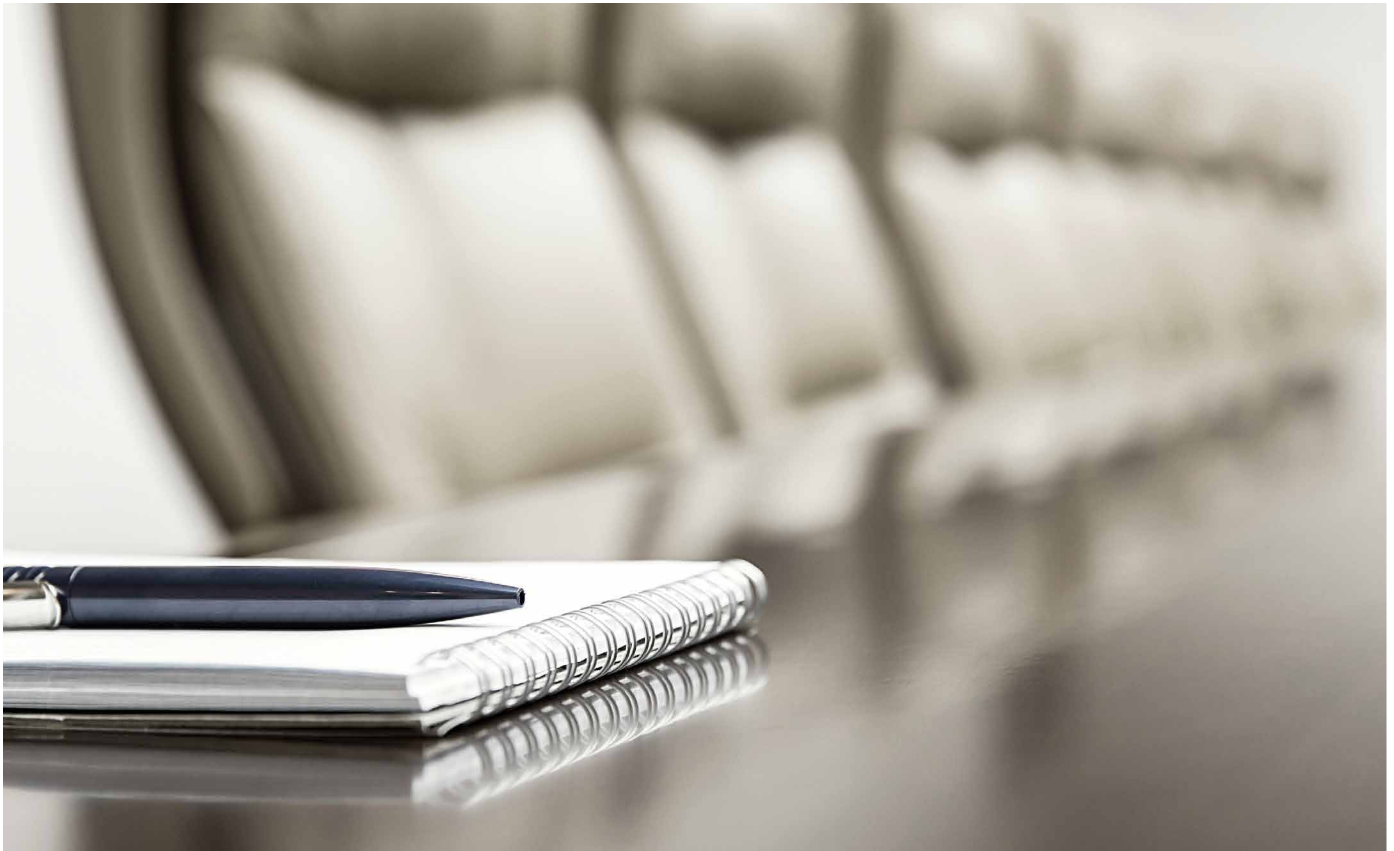
- Rules promulgated under section 103 of the Tax Administration Act 28 of 2011;
- Interpretation Note 15 (Issue 5) ("Exercise of discretion in case of late objection or appeal").

Cases

- *ABC (Pty) Ltd v Commissioner of the South African Revenue Service* (SARSSTC 0085/2019); [2020] ZATC 19 (1 September 2020).

Tags: grounds of assessment; notices of assessment; notice of objection; late objection or appeal.

REPORTABLE ARRANGEMENTS



The reportable arrangement provisions are set out in sections 34 to 39 of the Tax Administration Act (the TAA). In terms of section 37(1) of the TAA, the information required to be disclosed, in terms of the reportable arrangement provisions, must be disclosed by a person who is a "participant".

A "participant" is defined in section 34, in relation to an "arrangement", as:

- a "promoter" (ie, in relation to an arrangement, the person who is principally responsible for organising, designing, selling, financing or managing the arrangement);
- a person who directly or indirectly will derive or assumes that the person will derive a "tax benefit" or "financial benefit" (both defined in section 34), in relation to an arrangement; or
- any other person who is party to an arrangement listed in a public notice as referred to in section 35(2).

It must therefore be determined whether the transactions constitute a reportable arrangement in order to determine whether any participant has any reporting obligations in respect thereof. In this regard, the definition of an "arrangement", as contained in section 34, includes any transaction, operation, scheme, agreement or understanding (whether enforceable or not).

An "arrangement" is a "reportable arrangement":

- if it is listed by the Commissioner in a public notice in terms of section 35(2); or
- if, in terms of section 35(1), inter alia, a person is a "participant" in the arrangement and certain requirements set out in section 35(1)*(a)* to *(e)* have been met; and
- if it is not an excluded arrangement referred to in section 36.

Section 37 deals with the disclosure obligations. In this regard, the information referred to in section 38 in respect of a reportable arrangement must be disclosed by a person who is a "participant". In terms of section 37(1), a person who is a participant must disclose the information referred to in section 38 in respect of a reportable arrangement. In terms of section 37(2), a participant need not disclose the information if the participant obtains a written statement from any other participant that the other participant has disclosed the reportable arrangement.

If any entity or person constitutes a person who is "principally responsible for organising, designing, selling, financing or managing the arrangement" then it would constitute a "promoter". This is a question of fact. Any party to the above-mentioned transactions who directly or indirectly will derive or assumes that it will derive a tax benefit or financial benefit in relation to an arrangement will also constitute a "participant" as defined.

A "tax benefit" is defined in section 34 as including the "avoidance, postponement, reduction or evasion of any liability for tax".

A "financial benefit" is defined in section 34 as meaning "a reduction in the cost of finance, including interest, finance charges, costs, fees and discounts on a redemption amount".

It should also be considered whether an arrangement may be reportable as a result of the application of section 35(2). In terms of section 35(2), an arrangement will be reportable if the Commissioner for the South African Revenue Service (SARS) has listed the arrangement by public notice.

SARS published a notice as contemplated in sections 35(2) and 36(4) listing certain arrangements which are deemed to be reportable (see Government Notice 140, published on 3 February 2016, *GG* 39650) (the Notice).

Paragraph 2.1 of the Notice lists as a reportable arrangement:

> "An arrangement that would have qualified as a 'hybrid equity instrument' in terms of section 8E of the Income Tax Act, 1962, if the prescribed period in that section had been 10 years, but does not include any instrument listed on an exchange regulated in terms of the Financial Markets Act, 2012 (Act 19 of 2012)."

Paragraph 2.2 of the Notice provides that the following arrangement has been identified to be a reportable arrangement:

- a company buys back shares on or after the date of publication of this notice from one or more shareholders for an aggregate amount exceeding ZAR 10 million; and

- that company issued or is required to issue any shares within 12 months of entering into that arrangement or of the date of any buy-back in terms of that arrangement.

From the definition of a reportable arrangement is excluded any excluded arrangement contemplated in section 36. Accordingly, transactions will not be reportable if they fall within the exclusions listed in section 36.

Section 36(4) provides that the Commissioner may determine an arrangement to be an excluded arrangement by public notice.

The Notice lists as an "excluded arrangement" as:

1. "An arrangement referred to in section 35(1) of the Tax Administration Act, 2011, is an excluded arrangement if the aggregate tax benefit which is or may be derived from that arrangement by all participants to that arrangement does not exceed ZAR 5 million.

2. An arrangement referred to in section 35(1)*(c)* of the Tax Administration Act, 2011, is an excluded arrangement if the tax benefit which is or will be derived or is assumed to be derived from that arrangement is not the main or one of the main benefits of that arrangement."

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Acts and Bills

- Tax Administration Act 89 of 1991: Chapter 4: Part B – sections 34 to 39 (with specific reference to sections 34 (definitions of "arrangement", "financial benefit", "participant", "promoter", "reportable arrangement" and "tax benefit"), 35(1)*(a)* to *(e)* & (2), 36, 37(1) & (2) and 38);

- Income Tax Act 58 of 1962: Section 8E;

- Financial Markets Act 19 of 2012.

Other documents

- Government Notice 140 (published on 3 February 2016 in *GG* 39650): Paragraphs 2.1 and 2.2.

Tags: reportable arrangement; tax benefit; disclosure obligations.

VDP AND INTEREST REMISSIONS

Of late, the Voluntary Disclosure Programme (VDP) legislation in Chapter 16 of the Tax Administration Act, 2011 (the TAA), seems to be causing confusion in practice. This is brought about by a combination of the inconsistent application of the VDP provisions by SARS' VDP Unit as well as certain loosely worded provisions contained in Chapter 16.

An example of such a provision is section 229 of the TAA, which provides for the relief for which an applicant could qualify, should they participate in the VDP: ie, SARS must not pursue criminal prosecution for a tax offence arising from the default, SARS must grant relief in respect of understatement penalties and SARS must grant 100% relief in respect of administrative non-compliance penalties. The section, however, remains silent on relief from interest levied in terms of a VDP application. Additionally, Chapter 16, as a whole, is silent on the interest component of a VDP application.

This stance differs from the "old" VDP process, as under section 6 of the Voluntary Disclosure Programme and Taxation Laws Second Amendment Act, 2010, the Commissioner was empowered to grant 50% or 100% relief in respect of interest otherwise payable by the VDP applicant.

This begs the question of whether a VDP applicant can request the remission of interest outside the VDP process, via the normal channels, for example section 187 of the TAA (which has been partially promulgated), read with section 89*quat*(3) of the Income Tax Act, 1962, or section 39(7) of the Value-Added Tax Act, 1991 (the VAT Act).

In the recent case of *Medtronic International Trading S.A.R. L v The Commissioner for the South African Revenue Service* [2021] (the *Medtronic* case), SARS had refused to consider the Applicant's request for the remission of interest in terms of section 39(7)*(a)* of the VAT Act following the conclusion of two VDP agreements between SARS and the Applicant. The Applicant sought a review of, *inter alia*, this decision.

The facts of this case are that an employee of the Applicant had embezzled an amount of R537 236 176 from the Applicant. This was attained by the employee submitting false VAT201 returns to SARS and then seeking reimbursements from SARS in order to conceal her embezzlement.

The Applicant thus sought to regularise its affairs via the VDP. On 14 and 18 June 2018 two VDP agreements were concluded between SARS and the Applicant. According to these VDP agreements the Applicant was liable for the payment of the principal amount of R286 464 756.62 and interest of R171 205 356.12.

SARS' VDP Unit had waived all understatement and administrative noncompliance penalties amounting to R172m and also agreed to refrain from pursuing any criminal action against the applicant. The Applicant proceeded to sign the VDP agreement as well as pay over the capital and interest amounts to SARS.

The Applicant then sought to have the interest in the amount of R171 205 356.12 remitted in terms of section 39(7), which states:

> "(7) Where the Commissioner is satisfied that the failure on the part of the person concerned or any other person under the control or acting on behalf of that person to make payment of the tax within the period for payment contemplated in subsection (1)*(a)*, (2), (3), (4), (6), (6A) or (8) or on the date referred to in subsection (5), as the case may be –
>
> *(a)* was due to circumstances beyond the control of the said person, he or she may remit, in whole or in part, the interest payable in terms of section ...."

Further, the Applicant relied on the explanation of what constitutes "circumstances beyond a person's control" per Interpretation Note 61 (paragraph 4.3.2):

> "circumstances beyond a person's control are generally those that are external, unforeseeable, unavoidable or in the nature of an emergency, such as an accident, disaster or illness which resulted in the person being unable to make payment of VAT due."

"Further, the Applicant relied on the explanation of what constitutes "circumstances beyond a person's control" per Interpretation Note 61 (paragraph 4.3.2)"

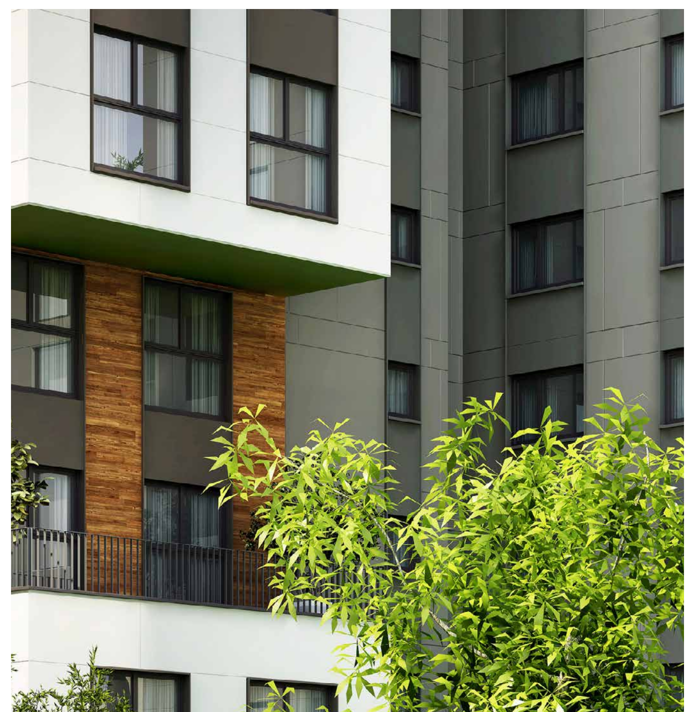
According to the Applicant, the embezzlement of funds by an employee of the Applicant was beyond the control of the Applicant.

However, SARS argued that the application of section 187(6) of the TAA and likewise section 39(7)*(a)* of the VAT Act are not applicable to a situation where the VDP agreement is in play. In addition, SARS alleged that the Applicant's request for remission of interest effectively constituted an attempt to renege on the VDP agreements.

The Gauteng High Court held that "it is evident that the interest and penalties were added to the eventual amount attained in the VDP agreement by virtue of the application of section 39(1) of the VAT Act."

Hughes J took the view that "if remission requests of interest were not intended to be sought in situations where there was a VDP agreement, either by way of section 187 of the [TAA] or section 39(7) of the VAT Act, the legislature would have set this out succinctly in the provisions regulating the VDP agreement and procedure."

On this basis, the court held that "the notion adopted by [SARS] that the Applicant seeks to vary the VDP agreement through the back door by seeking the remission cannot stand muster. This is so because it is common cause that the applicant has already complied with the VDP agreement as it has paid the interest sought" and went on to state that "The entire purpose of the VDP process pertains to taxes and is regulated by Acts which are tax related with the Tax Act being the default position if there is conflict or confusion. How then does one exclude that which is a self-



"Accordingly, the court held that the VDP provisions contained in the TAA do not prohibit a request for remission of interest in terms of section 39(7) of the VAT Act, notwithstanding a VDP agreement being entered into."

prevailing Act when dealing with a process borne out in that same Act. Hence, the analogy being that if section 187(6) can be applied then the equivalent that being section 39(7) of the VAT Act, most certainly is applicable."

Accordingly, the court held that the VDP provisions contained in the TAA do not prohibit a request for remission of interest in terms of section 39(7) of the VAT Act, notwithstanding a VDP agreement being entered into. The impugned decisions taken by SARS were pertinently swayed by errors in law, were not authorised by any empowering legislation and were made without important and relevant considerations being considered.

Ultimately, the decision made by SARS (ie, the refusal to consider the Applicant's request for the remission of interest in terms of section 39(7)*(a)* of the VAT Act) was referred to SARS for consideration.

CONCLUSION

- The *Medtronic* case provides welcome clarity for taxpayers who are undertaking the VDP process and who seek to request the remission of interest (in appropriate circumstances) borne out of the VDP process.
- Although the SARS VDP unit is not empowered to remit interest, this does not prohibit the taxpayer from seeking remission of interest via the standard procedures separately from or subsequent to its VDP application.
- It remains to be seen whether the *Medtronic* case is the final push for some of the VDP provisions in Chapter 16 of the TAA to be amended.

PwC

[*Editorial comment*: Please note that –

(i) the repeal of section 89*quat* of the Income Tax Act, 1962, by section 271 of the Tax Administration Act, 2011, is not yet operational – it is to be put into operation by proclamation in the *Government Gazette*;

(ii) the deletion or substitution of some subsections of section 39 of the Value-Added Tax Act, 1991, by section 271 of the Tax Administration Act, 2011, is not yet (fully) operational – it is to be put into operation by proclamation in the *Government Gazette* or by public notice by the Minister. In some cases the deletion or substitution has already come into operation *except to the extent that it relates to interest, in which case the wording prior to the deletion or substitution applies*.

For full details in this regard, see Interpretation Note 68 (Issue 3), published on 8 December 2020.]

Acts and Bills

- Tax Administration Act 28 of 2011: Section 187; Chapter 16 (sections 221 to 233 – more specifically section 229);
- Income Tax Act 58 of 1962: Section 89*quat*(3);
- Value-Added Tax Act 89 of 1991: Section 39(7) (also subsections (1), (2), (3), (4), (5), (6), (6A) & (8));
- Voluntary Disclosure Programme and Taxation Laws Second Amendment Act 8 of 2010: Section 6.

Other documents

- Interpretation Note 61 ("Remission of interest in terms of section 39(7)*(a)*" (of the VAT Act));
- Interpretation Note 68 (Issue 3) ("Provisions of the Tax Administration Act, 2011, that did not commence on 1 October 2012 under Proclamation 51 in *Government Gazette* 35687").

Cases

- *Medtronic International Trading S.A.R. L v The Commissioner for the South African Revenue Service* (33400/2019); [2021] ZAGPPHC 134; JDR 0490 (GP).

Tags: Voluntary Disclosure Programme (VDP); remission of interest; administrative noncompliance penalties.

WIDENING OF SCOPE OF TAX OFFENCES

The amendments to tax administration laws that were promulgated in January 2021 are indicative of SARS' need to focus on maximising collections and preserving liquidity.

The amendments to the Tax Administration Act, 2011 (the TAA), proposed in the Tax Administration Laws Amendment Act, 2020, were promulgated on 20 January 2021. The amendments to section 234 of the TAA significantly broaden the scope for the prosecution of tax offences, and appear to indicate that SARS and the National Prosecuting Authority (the NPA) intend to ramp up the criminal prosecution of non-compliant taxpayers.

"Since the advent of the TAA in 2011, section 234 has set out a list of criminal tax offences."

Since the advent of the TAA in 2011, section 234 has set out a list of criminal tax offences. Taxpayers found guilty of these offences can be prosecuted, and if convicted, imprisoned for a period of up to two years or subjected to a fine. The criminal tax offences range from serious offences, such as the deliberate (fraudulent) falsification of documents and the dissipation of assets to frustrate SARS in carrying out its duties, to relatively minor offences, such as failing to notify SARS of a change in the details of the taxpayer's public officer (as defined in section 1, read with section 246, of the TAA).

These offences have always been subject to the requirement that they must have been committed "wilfully and without just cause". The term "wilful" implies that the conduct must have been intentional. South African criminal law recognises different degrees of intentional conduct, including *dolus eventualis*, or the mere foreseeable possibility that certain conduct might lead to prohibited consequences. "Without just cause" refers to conduct that is unreasonable. For example, it is an offence to refuse to provide information requested by SARS, but under the old section 234, it would be reasonable (and therefore not an offence) for a taxpayer to refuse to disclose privileged advice.

Accordingly, it has always been understood that SARS and the NPA would only seek to prosecute tax offences where the taxpayer has deliberately and knowingly committed an offence. The amendments to section 234 now classify tax offences into two categories: conduct that constitutes an offence if it is wilfully committed, and conduct which can be criminally prosecuted if it is negligently committed.

This amendment therefore broadens the scope for the prosecution of taxpayers considerably, making a greater range of conduct (and a greater number of taxpayers) potentially subject to criminal sanctions. Under the new section 234, offences such as failing to update registered particulars, failing to submit tax returns or other information to SARS, and failing to withhold and pay any amount of tax can be prosecuted even when these failures are negligent (eg, the result of an administrative oversight).

Taxpayers (particularly representative taxpayers, such as directors and public officers) should take careful note of the increased scrutiny that is likely to follow this amendment in relation to record keeping and administrative compliance. The consequences of a criminal conviction under section 234 are severe, affecting a person's ability to hold certain positions, and to emigrate from South Africa.

In the context of SARS' strategic goal of restoring taxpayers' trust and voluntary compliance, it seems counterintuitive for SARS and the NPA to focus economic and human resources on the prosecution of relatively minor offences that do not cause any real harm or loss to the fiscus. Government should also carefully consider whether the NPA has the resources to investigate and prosecute a larger volume of tax offences, because the deterrent effect of the new section 234 will depend on its successful application in practice.

"The amendments to section 234 now classify tax offences into two categories: conduct that constitutes an offence if it is wilfully committed, and conduct which can be criminally prosecuted if it is negligently committed."

Bowmans

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 1 (definition of "public officer"), 234 (previous wording – until 20 January 2021 – and current wording) and 246;
- Tax Administration Laws Amendment Act 24 of 2020.

Tags: non-compliant taxpayers; criminal tax offences; administrative oversight.

VOUCHERS: A HIGH COURT DECISION

The VAT implications of vouchers may, on the face of it, seem to be of little significance and straightforward. However, VAT on vouchers has been the subject of a significant amount of litigation in the United Kingdom and the European Union. New Zealand has amended its VAT legislation twice in this regard and the United Kingdom substantially amended its VAT rules on vouchers from January 2019. SARS issued two draft interpretation notes during 2012 on the subject but neither have been finalised. It is therefore somewhat surprising that there have been very few VAT disputes in South Africa in relation to vouchers.

THE VAT CONSIDERATIONS APPLICABLE TO VOUCHERS

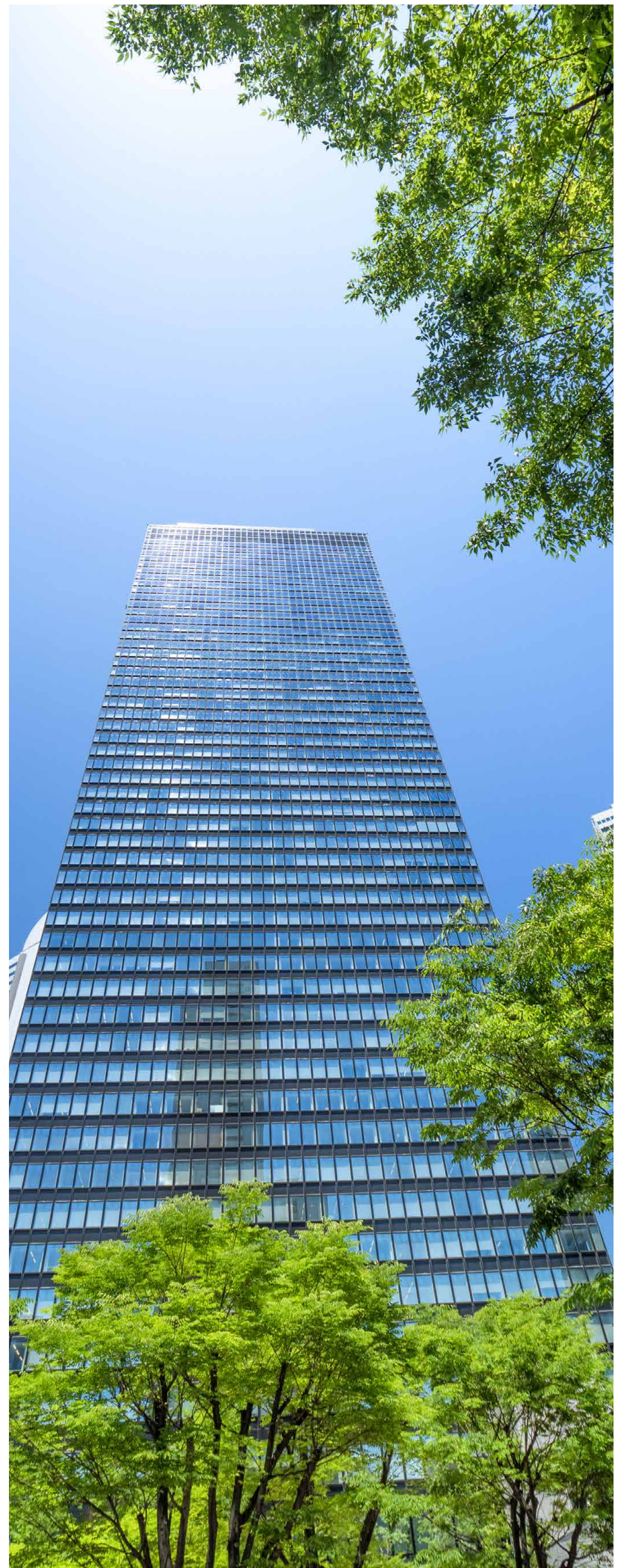
The problem with a voucher is that it is a prepayment for a later supply of goods or services on the redemption of the voucher. There is only a single consumption for a single consideration, but there are two transactions, ie, the sale of the voucher and the subsequent supply of goods or services. If both the transactions are taxed, then it will give rise to double taxation since there is only one consideration. To avoid such double taxation, the Value-Added Tax Act, 1991 (the VAT Act), contains provisions which are specific to vouchers.

Section 10(18) deals with vouchers which grant the holder the right, in return for the payment of a consideration in money, to receive goods or services to the extent of the monetary value stated on the voucher. The voucher holder determines the goods or services to be acquired, and there is often more than one supplier to choose from. Since the nature, value or VAT status of the goods or services (whether they are standard-rated, zero-rated or exempt) cannot be determined upfront, no VAT is payable when the voucher is sold. VAT is only payable when the voucher is redeemed for goods or services, and then only on the value of the goods or services supplied. In terms of the Explanatory Memorandum on the Value-Added Tax Bill, 1991, a section 10(18) voucher is regarded as a means of exchange, similar to money. Gift vouchers typically fall into this category.

Section 10(19) deals with vouchers issued for a consideration in money which entitle the holder to receive the goods or services specified thereon without any further charge. The VAT on these vouchers is payable when the vouchers are issued because the nature and VAT status of the goods or services are known when the voucher is sold, and no VAT is payable when the voucher is redeemed. Tickets entitling the holder entry to a specified sporting or entertainment event, a spa voucher entitling the holder to a specified treatment and prepaid electricity vouchers typically fall into this category.

The main difference is therefore that no VAT is accounted for when a section 10(18) voucher is issued, and VAT is only accounted for on the value of goods or services supplied when the voucher is redeemed, whereas, in the case of a section 10(19) voucher, VAT is payable on the full consideration when the voucher is issued, and no VAT is payable when the voucher is redeemed for goods or services.

"The main difference is therefore that no VAT is accounted for when a section 10(18) voucher is issued, and VAT is only accounted for on the value of goods or services supplied when the voucher is redeemed, whereas, in the case of a section 10(19) voucher, VAT is payable on the full consideration when the voucher is issued, and no VAT is payable when the voucher is redeemed for goods or services."



HIGH COURT JUDGMENT

The High Court was called upon in the case of *MTN (Pty) Ltd v Commissioner for the South African Revenue Service*, [2021], to determine whether prepaid vouchers issued for a consideration, entitling the holder to receive any services or products to the value of the monetary value attributed to the voucher on the MTN mobile network as selected by the holder (multi-purpose vouchers), comprise section 10(18) or 10(19) vouchers.

MTN applied in November 2017 to SARS for a binding private ruling to confirm that its multi-purpose vouchers fall within section 10(18). However, SARS ruled in April 2019 that these vouchers are section 10(19) vouchers. MTN then sought a declaratory order from the High Court that the multi-purpose vouchers indeed fall within section 10(18). As has seemingly become its standard practice in such cases, SARS firstly disputed the entitlement of MTN to declaratory relief. SARS argued that MTN was asking the court to advise it on which section of the VAT Act should be applied. SARS argued further that the court was requested to make a determination on general terms, that it was not time-specific and that there were not sufficient facts upon which a determination could be made.

In the judgment handed down on 12 January 2021, Hughes J confirmed the entitlement of MTN to seek declaratory relief. In relying on the judgment of the Supreme Court of Appeal in *Commissioner for the South African Revenue Service v Langholm Farms (Pty) Ltd*, [2019], he stated that nothing would change SARS' interpretation of this specific section and no amount of further facts or information would alter SARS' legal view. In these circumstances, a declaratory application is appropriate.

Turning to the application of section 10(18) and 10(19), the court considered that the vouchers are prepaid vouchers which allow the subscriber access to any of MTN's services. When the subscriber purchases and activates the multi-purpose voucher, the subscriber's SIM card is credited with the value of the voucher. This is described as the "main wallet", which can then be used to acquire any product or service on the MTN network at the choice of the subscriber. Once a particular product or service is accessed, the cost thereof at the prevailing tariff is deducted from the main wallet.

The court stated that the multi-purpose voucher is described as an "airtime" voucher. The "airtime" voucher can be used to make calls, receive calls, send messages and use the internet and also for data. It is this "airtime" which the court regarded to be a specific good or service as contemplated by section 10(19), which can then be used for multiple purposes. The court therefore held that the voucher is for specified goods or services and is therefore a section 10(19) voucher.

"The judgment in the MTN case leaves us with more questions than answers on the complex subject of VAT and vouchers. The provisions of the VAT Act which deal with vouchers were included in the VAT Act when VAT was introduced almost 30 years ago and have not been amended since."

A DEEPER DIVE – ANALYSIS AND PRACTICAL IMPLICATIONS OF THE JUDGMENT

It is not clear whether the court considered the judgment of the tax court in ITC 1918 [2019]. In that case Binns-Ward J ruled that pre-paid vouchers are regulated by sections 63 and 65 of the Consumer Protection Act, 2008 (the CPA). Section 63(3) provides that any consideration paid by a consumer in exchange for a prepaid voucher is the property of the bearer of that voucher to the extent that the recipient has not redeemed it in exchange for goods or services. Section 65(2)*(a)* of the CPA provides that the supplier must not treat the prepayment as being the property of the supplier. On this basis, the tax court held that it is only when the voucher is redeemed or expires that the sale proceeds of the voucher accrues to the taxpayer, for it is only then that the taxpayer becomes legally entitled to the proceeds. The tax court therefore held that the proceeds are not gross income for income tax purposes until the voucher is redeemed or expires. The same principles should also apply in a VAT context.

MTN argued that the sale proceeds of its multi-purpose voucher only comprise revenue when the voucher is activated and used. Hughes J stated that this contention is not correct because section 9(1) of the VAT Act requires MTN to account for VAT in the tax period in which the voucher is sold. This is, however, incorrect on two counts. Firstly, if it is a section 10(18) voucher, then the supply of the voucher is disregarded for the purposes of the VAT Act. There is then no supply which triggers the time of supply in terms of section 9(1). Secondly, the time of supply in terms of section 9(1) is triggered at the earlier of the time that an invoice is issued or that any payment of consideration is received by the supplier. Assuming no invoice is issued in respect of a prepaid voucher, VAT is then only payable when payment of consideration is received by the supplier. Section 63(3) of the CPA provides specifically that any consideration paid for a prepaid voucher is the property of the bearer of that voucher to the extent that the supplier has not redeemed it in exchange for goods or services. Section 65(2)*(a)* of the CPA further places a prohibition on the supplier to treat such prepayment as the supplier's property. The consideration paid for the multi-purpose voucher is therefore not a consideration received by the supplier which triggers the time of supply under section 9(1), as it remains the property of the bearer.

The judgment in the *MTN* case also has further implications. One of the reasons why section 10(18) delays the VAT payment until the voucher is redeemed, is because the nature of the goods or services, and whether they are standard-rated, zero-rated or exempt, cannot be determined at the time the voucher is sold. In the case of MTN, the current products or services for which the multi-purpose voucher can be used are all standard-rated. However, if MTN adds zero-rated, exempt or non-taxable options for which the main wallet can be applied, for example to make a donation to a charity or to pay a credit life insurance premium, such non-taxable transactions will be subject to VAT because the multi-purpose voucher is now ruled to be a section 10(19) voucher. A further question that arises is who should pay the VAT, and when, if a multi-purpose voucher such as the MTN voucher is issued by a third party. What would the position be if a third party issues a multi-purpose voucher which can be redeemed for services or products provided by multiple service providers?

The judgment in the *MTN* case leaves us with more questions than answers on the complex subject of VAT and vouchers. The provisions of the VAT Act which deal with vouchers were included in the VAT Act when VAT was introduced almost 30 years ago and have not been amended since. The VAT Act has not kept up with the rapid expansion in digital technologies and the proliferation in business promotion initiatives involving vouchers. Perhaps now is the time to review and amend these provisions.

Cliffe Dekker Hofmeyr

Acts and Bills

Value-Added Tax Act: Sections 9(1) & 10(18) & (19);

- Consumer Protection Act 68 of 2008: Sections 63 & 65 (more specifically sections 63(3) & 65(2)*(a)* & (3)).

Other documents

- Explanatory Memorandum on the Value-Added Tax Bill, 1991.

Cases

- *MTN (Pty) Ltd v Commissioner for the South African Revenue Service* [2021] ZAGPPHC (79960/2019);
- *Commissioner for the South African Revenue Service v Langholm Farms (Pty) Ltd* [2019] 82 SATC 135; ITC 1918 [2019] 81 SATC 267;
- *ITC 1918* (IT 24510); [2019] 81 SATC 2019.

Tags: standard-rated; zero-rated; declaratory relief; multi-purpose voucher.